No. 75-1172

In The

Supreme Court of the United States

October Term, 1975

Fidelity and Deposit Company of Maryland,
Petitioner,

v.

USAFORM Hail Pool, Inc., et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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SUBJECT INDEX

PAGE

OPINIONS BELOW 1

JURISDICTION 3

QUESTIONS PRESENTED 3

CONSTITUTIONAL PROVISIONS, STATUTES AND FEDERAL RULES INVOLVED 4

Constitutional Provisions 4

Federal Statutes 5

Federal Rules of Civil Procedure 5

Federal Rules of Appellate Procedure 6

STATEMENT OF THE CASE 7

REASONS FOR GRANTING PETITIONER'S WRIT OF CERTIORARI 15

I. The Court of Appeals' Affirmance of the District Court's Vacation and Reentry of Its Original Judgment Under the Alleged Authority of Fed. R. Civ. P. 60(b)(6) for the Sole Purpose of Restoring an Otherwise Lost Right of Appeal Merits Review Because Such Action Contravenes Fed. R. Civ. P. 77(d), F.R.A.P. 4(a), and 28 U.S.C.A. § 2107, and is in Direct Conflict with the Decisions of Other Circuits, and Additionally Presents an Important Question of Federal Law Which Has Not Been, But Should be Settled by this Court 16

A. The Holding of The Court of Appeals Is Contrary to the Express Provisions of F.R.A.P. 4(a), Fed. R. Civ. P. 77(d), and 28 U.S.C.A. § 2107 16

SUBJECT INDEX (Continued)

PAGE

B. Fed. R. Civ. P. 60(b) Does Not Expressly or Impliedly Authorize a District Court to Vacate and Reenter Its Judgment for the Sole Purpose of Reviving an Otherwise Lost Right of Appeal in Contravention of Fed. R. Civ. P. 77(d), F.R.A.P. 4(a) and 28 U.S.C.A. § 2107 18

C. The Court of Appeals' Decision Conflicts With Other Circuit Decisions that Deny a District Court's Authority Under Rule 60(b)(6) to Vacate and Reenter Its Judgment Solely to Restore an Otherwise Lost Right of Appeal 22

II. The Court of Appeals' Decision Merits Review by this Court for the Further Reason that the Court of Appeals Clearly Erred in Assuming Jurisdiction to Review the Judgment of the District Court which Dismissed the Counterclaim Filed Against Petitioner by Respondent, Pan American, Ltd., and in Vacating that Judgment, When Pan Am Filed No Notice of Appeal Whatsoever as is Clearly Required by F.R.A.P. 4(a) 25

III. The Court of Appeals' Decision Merits Review by this Court Because It: (1) Construed an Unambiguous Insurance Contract; (2) Held that the Respondent Insureds Need Not Prove Fraud or Dishonesty; (3) Eliminated the Contractual Requirement of Causation; and (4) Shifted the Burden of Proof to the Insurer to "Disprove" an Insurable Loss Under the Fidelity Bond and, thus Decided Important State Questions in a Manner so as to Conflict with Applicable State Law and Further Disregarded this Court's Dictates in *Erie* v. *Tompkins* and its Progeny 26

SUBJECT INDEX (Continued)

PAGE

IV. The Court of Appeals' Decision Merits Review by this Court Because It Effectively Modifies and Repudiates an Earlier Opinion of the Court of Appeals Which Constituted the Law of the Case and, thus, Manifestly Exceeds the Court's Appellate Jurisdiction so as to Call for an Exercise of this Courts Power of Supervision 33

V. The Court of Appeals' Opinion Merits Review by this Court Because the Court of Appeals Failed to Properly Discharge Its Appellate Functions Under Fed. R. Civ. P. 52(a) in Reviewing the District Court's Findings of Facts and Conclusions of Law and Subsequently Vacating and Remanding Said Judgment for Additional Findings 35

VI. The Court of Appeals' Opinion Merits Review Because Its Shifting the Burden of Proof to the Insurer to "Disprove" an Insured Loss by Means of a Newly Created Presumption Without Remanding the Cause for a New Trial Constitutes a Denial of Procedural Due Process Under U.S. Const. Amend. V. 37

Conclusion and Prayer 39

Certificate of Service 40

INDEX OF AUTHORITIES

PAGE

American Empire Insurance Company of South Dakota v. Fidelity and Deposit Co. of Maryland, 408 F.2d 72 (5th Cir. 1969) *cert. den.* 396 U.S. 818, 90 S.Ct. 55, 24 L.Ed. 2d 69 ... 2, 10

Barrett v. Quesnel, 90 So. 2d 706 (Fla. 1956) ...

Bergholm v. Peoria Life Ins. Co., 284 U.S. 489, 52 S.Ct. 230, 76 L.Ed. 416 (1932) ... 29

Bernhardt v. Polygraphic Co. of America, 350 U.S. 198, 76 S.Ct. 273, 100 L.Ed. 199 (1956) ... 27

Biscayne Boulevard Properties v. Graham, 65 So. 2d 858 (Fla. 1953) ... 32

Brainerd v. Beal, 498 F.2d 901 (7th Cir. 1974) ... 24

Clay v. Sun Insurance Office, Ltd., 363 U.S. 207, 80 S.Ct. 1222, 4 L.Ed. 2d 1170 (1960) ... 27

Dick v. New York Life Ins. Co., 359 U.S. 437, 79 S.Ct. 921, 3 L.Ed. 2d 935 (1959) ... 32

Erie Railroad Co. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938) ... 27

Fidelity and Deposit Co. of Maryland v. Usaform Hail Pool, Inc., et al., 318 F.Supp. 1301 (D.C.M.D. Fla. 1970) *rev'd* 463 F.2d 4 (5th Cir. 1972) ... 11

Fidelity and Deposit Co. of Maryland v. Usaform Hail Pool, Inc., et al., 463 F.2d 4 (5th Cir. 1972) ... 11

Files v. City of Rockford, 440 F.2d 811 (7th Cir. 1971) ... 24

Hellis v. Ward, 308 U.S. 365, 60 S. Ct. 283, 84 L.Ed. 327 (1939) ... 38

Hill v. Hawes, 320 U.S. 520, 64 S.Ct. 334, 88 L.Ed. 283 (1944) ... 18

Hodgson v. United Mine Workers of America, 473 F.2d 118 (D.C. Cir. 1972) ... 22

INDEX OF AUTHORITIES (Continued)

PAGE

Jergins v. Schenck, 162 Cal. 747, 124 P. 426 (1912) ... 19

Klaxon Co. v. Stentor Electric Mfg. Co., 313 U.S. 487, 61 S.Ct. 1021, 85 L.Ed. 1477 (1941) ... 27

Knapp v. North American Rockwell Corp., 506 F.2d 361 (3rd Cir. 1974) ... 35

Lathrop v. Oklahoma City Housing Authority, 438 F.2d 914 (10th Cir. 1971), *cert. den.* 404 U.S. 940, 92 S.Ct. 132, 30 L.Ed. 2d 73 ... 24

Lord v. Helmandollar, 384 F.2d 780, 121 U.S. App. D.C. 168 (D.C. Cir. 1965), *cert. den.* 383 U.S. 928, 86 S.Ct. 929, 15 L.Ed. 2d 874 ... 24

Lynch v. United States, 292 U.S. 571, 54 S.Ct. 840, 78 L.Ed. 1434 (1934) ... 27

McAllister v. United States, 348 U.S. 19, 75 S.Ct. 6, 99 L.Ed. 748 (1954) ... 37

McGregor v. Provident Trust Co. of Philadelphia, 119 Fla. 718, 162 So. 323 (1935) ... 32

McKee v. Great American Insurance Company, 316 F.2d 473 (5th Cir. 1973, *per curiam*) ... 35

Mississippi Publishing Corp. v. Murphree 326 U.S. 438, 66 S.Ct. 242, 90 L.Ed. 185 (1946) ... 17

Nichols-Morris Corporation v. Morris, 279 F.2d 81 (2d Cir. 1962) ... 24

Radack v. Norwegian American Line Agency, Inc., 318 F.2d 538 (2d Cir. 1963) ... 24

Richland Knox Mutual Insurance Co. v. Kallen, 376 F.2d 360 (6th Cir. 1967) ... 24

Saunders v. Shaw, 244 U.S. 317, 37 S.Ct. 638, 61 L.Ed. 1163 (1917) ... 38, 39

Smith v. Jackson Tool & Die, Inc., 426 F.2d 5 (5th Cir. 1970) ... 20, 21

INDEX OF AUTHORITIES (Continued)

PAGE

Sonnenblick-Goldman Corp. v. Nowalk, 420 F.2d 860 (3rd Cir. 1970) 24

Southern Home Insurance Co. v. Putnal, 52 Fla. 199, 49 So. 922, 930 (1909) 26

United States v. F & M Schaeffer Brewing Co., 356 U.S. 227, 78 S.Ct. 674, 2 L.Ed. 2d 721 (1958) 24

United States v. United States Gypsum Co., 333 U.S. 364, 68 S.Ct. 525, 92 L.Ed. 746 (1948) 36, 37

United States v. Indrelunas, 411 U.S. 216, 93 S.Ct. 1562, 36 L.Ed. 2d 202 (1973) 25

Zenith Corporation v. Hazeltine, 395 U.S. 100, 89 S.Ct. 1562, 23 L.Ed. 2d 129 (1969) 36, 37

CONSTITUTIONAL PROVISIONS CITED

PAGE

U.S. Const. Amend. V 4, 38, 39

STATUTES CITED

28 USCA § 1254 (1) Jurisdiction of this Court 3, 5

28 USCA § 1291 ..... 3, 5

28 USCA § 1332 Jurisdiction of District Court 5

28 USCA § 2107 ..... 3, 5

FEDERAL RULES

Fed. R. Civ. P. 52 (a) 4, 5

Fed. R. Civ. P. 60 (b)(6) 2, 6

Fed. R. Civ. P. 77 (d) 3, 6

F.R.A.P. 4 (a) 3, 6

STATE STATUTES

West's F.S.A. § 627.419 29

STATE RULES

Calif. Code Civ. Proc. § 473 20

MISCELLANEOUS

9 Moore's Federal Practice (2d Ed.), ¶ 204.13 (2) 24

Freeman, A Treatise on the Law of Judgments (5th Ed. 1925) 20

No. . . . .

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, which was entered on November 20, 1975.

OPINIONS BELOW

1. The opinion of the Court of Appeals, rendered on November 20, 1975, is not officially reported, but will be reported in .... F.2d .... (5th Cir. 1975). The opinion and the judgment vacating the judgment of the District Court and remanding the case are printed in Appendix A, *infra,* at pp. A-1 to A-49.

2. The District Court's findings of facts and conclusions of law filed January 14, 1974, are not officially reported. They and the judgment, dismissing the counterclaims against petitioner, are printed in Appendix B, *infra,* at pp. B-1 to B-35.

3. The opinion and order of the District Court entered on January 14, 1974, granting respondents' motion for relief from the judgment, entered on August 2, 1973, under Fed. R. Civ. P. 60(b)(6), and vacating its findings of facts, conclusions of law, and judgment entered on August 2, 1973, are not officially reported, and are printed in Appendix C, *infra,* at pp. C-1 to C-10.

4. The District Court's findings of facts and conclusions of law filed August 2, 1973 are not officially reported. They and the judgment entered on August 2, 1973, dismissing all counterclaims against petitioner, are printed in Appendix D, *infra,* at pp. D-1 to D-27.

5. The opinion of the Court of Appeals, rendered on July 3, 1972, which vacated the judgment entered against petitioner on September 25, 1970, and remanded the case to the District Court for further consideration and findings in light of correct principles of law announced therein, is officially reported in 463 F.2d 4 (5th Cir. 1972), and is printed in Appendix E, *infra,* at pp. E-1 to E-7.

6. The opinion of the District Court, rendered on September 25, 1970, is officially reported in 318 F.Supp. 1301. The opinion and judgment entered against petitioner are printed in Appendix F, *infra,* at pp. F-1 to F-25.

7. The opinion of the Court of Appeals, and the dissenting opinion of Wisdom, J., entered on March 6, 1969, is officially reported as *American Empire Insurance Company of South Dakota* v. *Fidelity and Deposit Company of Maryland,* 408 F.2d. 72 (5th Cir. 1969), *cert. den.* 396 U.S. 818, 90 S.Ct. 55, 24 L.Ed. 2d 69, and is printed in Appendix G, *infra,* at pp. G-1 to G-15.

8. The opinion and final summary judgment of the District Court, entered on November 14, 1966, is not officially reported, and is printed in Appendix H, *infra,* at pp. H-1 to H-6.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered on November 20, 1975, and a copy is printed in Appendix A, *infra,* at pp. A 27-28. The jurisdiction of this Court is invoked under 28 U.S.C.A. § 1254(1). The opinion was filed on November 20, 1975, and mandate was stayed to and including February 18, 1976. No Motion for Rehearing was filed.

QUESTIONS PRESENTED

1. Whether Fed. R. Civ. P. 60(b)6 authorizes the District Court to vacate and reenter its judgments for the sole purpose of extending the time for filing a notice of appeal beyond the prescribed limitations of F.R.A.P. 4(a) and 28 U.S.C.A. § 2107, and in direct contravention of Fed. R. Civ. P. 77(d)?

2. Whether the Court of Appeals has appellate jurisdiction to render a decision with regard to a party which has never filed a notice of appeal as required by F. R. A. P. 4(a) and 28 U.S.C.A. § 2107?

3. Whether a federal court of appeals has exceeded its constitutional and statutory authority in a diversity action in rewriting a fidelity bond contract and shifting the burden of proof on a material issue contrary to applicable state substantive law?

4. Whether the United States Court of Appeals has exceeded its constitutional and statutory authority in a diversity action in shifting the burden of proof to an insurer to "disprove" an insured loss in utter disregard of the contract, applicable Florida law and, thus, contrary to this Court's mandate in *Erie* v. *Tompkins?*

5. Whether the United States Court of Appeals may vacate findings of fact of the district court without applying the clearly erroneous standard dictated by Fed. R. Civ. P. 52(a)?

6. Whether a United States Court of Appeals has appellate jurisdiction or authority to alter the law of the case enunciated in earlier appellate opinions and mandates in order to vacate the District Court's findings of fact which were correctly determined in accordance with the earlier established law of the case?

7. Whether a party litigant is denied procedural due process by a decision which creates a new presumption of illegality that shifts the burden of proof on a material issue to such party for the first time on appeal, and the Court of Appeals refuses to remand for retrial but merely vacates the District Court's judgment and findings and directs the District Court to enter new findings on the disputed issue based solely on evidence adduced at a prior trial wherein the court and all parties had tried the case on the theory that the party opponent had the burden of proof on such issue?

CONSTITUTIONAL PROVISIONS, STATUTES AND FEDERAL RULES INVOLVED

Constitutional Provisions

U.S. Const. amend. V:

> "No person shall * * * be deprived of life, liberty, or property, without due process of law * * *."

Federal Statutes

28 U.S.C.A. § 1254:

> "Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:
>
> "(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree * * *."

28 U.S.C.A. §1332:

> "(a) The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and is between —
>
> "(1) Citizens of different States * * *."

28 U.S.C.A. § 2107:

> "Except as otherwise provided in this section, no appeal shall bring any judgment, order or decree in an action, suit or proceeding of a civil nature before a court of appeals for review unless notice of appeal is filed, within thirty days after the entry of such judgment, order or decree.
>
> * * *
>
> "The district court may extend the time for appeal not exceeding thirty days from the expiration of the original time herein prescribed, upon a showing of excusable neglect based on failure of a party to learn of the entry of the judgment, order or decree."

Federal Rules of Civil Procedure

Fed. R. Civ. P. 52:

> "(a) In all actions tried upon the facts without a jury * * *, the court shall find the facts specially and state separately its conclusions of law thereon, and a judgment shall be entered pursuant to Rule 58 * * *.

Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

Fed. R. Civ. P. 60:

"(b) On motion and upon such terms as are just, the court may relieve a party or his legal representative from final judgment, order, or proceeding for the following reasons: * * * (6) any other reason justifying relief from the operation of the judgment, * * *. A motion under this subdivision (b) does not affect the finality of the judgment or suspend its operation."

Fed. R. Civ. P. 77:

"(d) Immediately upon the entry of an order or judgment the clerk shall serve a notice of the entry by mail in the manner provided for in Rule 5 upon each party who is not in default for failure to appear, and shall make a note in the docket of the mailing. * * *. Lack of notice of the entry by the clerk does not affect the time to appeal or relieve or authorize the court to relieve a party for failure to appeal within the time allowed, except as permitted in Rule 4(a) of the Federal Rules of Appellate Procedure."

Federal Rules of Appellate Procedure

F.R.A.P. 4:

"(a) In a civil case * * * in which an appeal is permitted by law as of right from a district court to a court of appeals the notice of appeal required by Rule 3 shall be filed with the clerk of the district court within 30 days of the date of the entry of the judgment or order appealed from * * *.

"* * * A judgment or order is entered within the meaning of this subdivision when it is entered in the civil docket.

"Upon a showing of excusable neglect, the district court may extend the time for filing the notice of appeal by any party for a period not to exceed 30 days from the expiration of the time otherwise prescribed by this subdivision. Such an extension may be granted before or after the time otherwise prescribed by this subdivision has expired; but if a request for an extension is made after such time has expired, it shall be made by motion with such notice as the court shall deem appropriate."

STATEMENT OF THE CASE

The Court of Appeals' decision is the product of the third appeal since August 30, 1963, when Fidelity and Deposit Company of Maryland (F & D), petitioner herein, initiated this diversity action for a declaratory judgment against Usaform Hail Pool, Inc. (Hail Pool), U.S. & Foreign Management, Ltd. (Limited), U.S. & Foreign Management, Inc. (Management), and Barbara B. Murphy, Receiver for the three corporate defendants, and sought a judicial determination of the rights and obligations of the parties to a fidelity bond, wherein F & D was named as Underwriter, and Hail Pool, Limited, Management, Usaform Pan American, Ltd. (Pan Am), Halifax Insurance Agency, Inc. (Halifax), and two or three other affiliated corporations no longer material here, were named as joint insureds.[1]

[1] Insuring Agreement

"The Underwriter, in consideration of the payment of the premium, and subject to the Declarations made a part hereof, the General Agreements, Conditions and Limitations, and other terms of this Bond, agrees to indemnify the Insured against any loss of money or other property which the Insured shall sustain through any fraudulent or dishonest act or acts committed by any of the Employees, acting alone or in collusion with others, the amount of indemnity on each of such employees being the amount stated in Item 3 of the Declarations."

Appellate Jurisdiction

Respondents' failure to file any Notice of Appeal until 109 days after entry of the judgment presents a threshhold question of jurisdiction. Respondents had failed to learn of the entry of judgment until 103 days after entry and thereafter sought relief in the District Court by filing (1) notice of appeal; (2) a motion for new trial; (3) a motion for relief under Rule 60b(6); and (4) a motion for leave to file notice of appeal instanter. Pan Am did not join in these motions nor has it filed any notice of appeal to date.

Aside from complaints addressed to the District Court's alleged legal errors, such motions were wholly predicated on Respondents' failure to learn of the entry of judgment. That the clerk had failed to send notice of such entry is

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Joint Insured

"B. If more than one Insured is covered under this Bond, the Insured first named shall act for itself and for every other Insured for all purposes of this Bond. Knowledge possessed or discovery made by any Insured or by any partner or officer thereof shall, for the purposes of Sections 6, 7 and 12, constitute knowledge possessed or discovery made by every Insured. Cancellation of the insurance hereunder as respects any Employee as provided in Section 12 shall apply to every Insured. * * * The liability of the Underwriter for loss sustained by any or all of the Insureds shall not exceed the amount for which the Underwriter would be liable had all such loss been sustained by any one of the Insureds. Payment by the Underwriter to the Insured first named of any loss under this Bond shall fully release the Underwriter on account of such loss." * * *

Ownership of Money or Other Property

"Section 5. The insured property may be owned by the Insured, or held by the Insured in any capacity whether or not the Insured is liable for the loss thereof, or may be property as respects which the Insured is legally liable."

undisputed. Petitioner did contest the District Court's authority to grant any of the requested relief, but the Court nevertheless vacated and re-entered its previous judgment in reliance on Rule 60b(6), *infra* at page 6. The Court acted solely to restore Respondents' otherwise lost right of appeal. The Court of Appeals overruled Petitioner's motion to dismiss the appeal for want of jurisdiction based on the unavailability of such relief under F.R.A.P. 4(a), 28 U.S.C.A., § 2107 and Fed. R. Civ. P. 77(d). The Court even refused to dismiss the appeal as to Pan Am, which has never filed notice of appeal. This refusal is especially illuminating of the Court's preconceived attitude toward the merits of Respondents' appeal.

Litigation History

This petition is directed at the third Court of Appeals' opinion arising out of the subject transaction. The merits of this petition focus on the Court of Appeals' frontal assault on the previously established law of the case, as well as the Court's outright refusal to determine and correctly apply Florida substantive law. Although the previous opinions and judgments are appended to this petition, a brief review of the issues resolved in the earlier appeals is imperative to a proper understanding of Petitioner's challenge to the Court's most recent decision.

After this diversity action was commenced, the District Court permitted the intervention of Pan Am and various insurance companies to whom Hail Pool and Limited owed debts for premiums, but who were not named insureds. Intervenors variously counterclaimed as either joint insureds or third-party beneficiaries of the bond.

On November 14, 1966, the District Court entered final summary judgment against all counterclaiming intervenors, and held that they were neither insureds nor third-party beneficiaries of the bond. (Appendix H, *infra,* at pp. H-1 to H-6). All defendants and counterclaimants appealed and, on March 6, 1969, the Court of Appeals affirmed the District Court judgment. *American Empire Ins. Co. of South Dakota* v. *Fidelity and Deposit Co. of Maryland,* 408 F.2d 72 (5th Cir. 1969), *cert. den.* 396 U.S. 818, 90 S.Ct. 55, 24 L.Ed.2d 69 (Appendix G, *infra,* at pp. G-1 to G-15).

The Court remanded to the District Court for trial on the remaining issue of whether Hail Pool, Limited, and Pan Am, as insureds, had sustained any loss of money or other property through any fraudulent or dishonest acts of their employees.

From the first filed proof of loss on the bond through the pleadings, evidence and findings to date, Respondents have consistently sought recovery under the bond for the alleged fraudulent and dishonest invasion of premium monies owned by the various intervenors and held by the joint insureds. No other fraud or dishonesty has ever been pleaded, proved, or found.

On August 3, 1970, the case was tried to the District Court on the legal theory that Section 5 of the bond covered the premium moneys alleged to belong to the pool participants and underwriters group, and that when the insured corporations, through their employees, used the premium monies, alleged to be "trust funds" to pay their operating expenses, their debts, and in the transaction of corporate business, then the insureds, through their employees, fraudulently embezzled or diverted those premium monies belonging to the pool participants and underwriters group.

In its opinion, under the heading of *Fraudulent and Dishonest Acts,* the District Court discusses the transfer of "trust funds" from the premium accounts maintained by Hail Pool, Limited, and Pan Am, and it finds the amounts so transferred from each account. It then found as follows:

> "The Court finds that the foregoing transfers * * * made by Clarke or his employees at his direction, at a time when (Hail Pool, Limited, and Pan Am) were insolvent, was a dishonest and fraudulent invasion by Clarke of a trust fund clearly belonging to the pool participants (and underwriters group), and protected against such loss by Section 5 of the bond."

The same finding was made for all three insured corporations. Judgment was entered against F & D, and in favor of the insureds for the debts they owed to the pool participants and underwriters group. *Fidelity and Deposit Co. of Maryland* v. *Usaform Hail Pool, Inc. et al.,* 318 F.Supp. 1301 (D.C. M.D.Fla. 1970); (Appendix F, *infra,* at pp. F-1 to F-25).

F & D appealed from that judgment, and the Court of Appeals held that: "Because the district court used the wrong standard of law in determining the amount of liability on the bond, we reverse and remand for further consideration." 463 F.2d at 5. (Appendix E, *infra,* at E-2)

Next, the Court said: "The critical question determinative of this appeal is whether the claimants can recover on a bond insuring the fidelity of their employees when the employees took nothing from the claimant corporations, but used 'trust' funds to pay legitimate corporate obligations. We hold that they cannot." 463 F.2d at 5. (Appendix E, *infra,* at E-2).

The Court then held: "The fact that must be remembered in this case is that the bond was written to protect against loss to the insureds, not the losses of third parties." (Appendix E, *infra* at E-3) In footnote 2, the Court reiterated: "In the prior appeal, Judge Dyer, speaking for the Court said: 'We are of the firm view that F & D's contract meant just exactly what it clearly said, that is, that it insured the named corporations and those corporations only, against the defalcation of their employees.' (*Id.*) "The case must be viewed as if the insured companies were solvent and had adequate funds in their general accounts to replace the money diverted from the premium accounts. If the insureds cannot recover on the bond in that situation, their insolvency does not improve their case against the bonding company." In footnote 3, the Court cites *Scott v. Armstrong,* 146 U.S. 499,.507, 13 S.Ct. 148 (2892), and two other cases for the proposition. (*Id.*)

Finally, the Court held: "We hold that the taking of money from the premium account of an insured company to pay other legitimate obligations of that company does not constitute a loss within the meaning of the fidelity bond before us in this case. Since the findings of the district court were not addressed specifically to the question of whether funds taken from the insured companies' premium accounts went to pay legitimate expenses of the respective companies, we vacate the judgment entered below and remand the case for further consideration and the entry of additional findings of fact." 463 F.2d at 7. (Appendix E, *infra,* at E-6).

Proceedings in the District Court After Remand

The District Court subsequently directed Hail Pool, Limited, and Pan Am to list the specific items of loss they

would contend the record evidence show are losses sustained by the insureds through fraudulent or dishonest acts of their employees which are covered by the bond in light of the decision of the Court of Appeals. The Court directed F & D to file a specific response to each item of loss specified by the insureds.

On November 29, 1972, Hail Pool, Limited, and Pan Am filed schedules of items, in which they listed items of loss which they claimed each insured corporation had sustained within the coverage of the bond, in light of the decision of the Court of Appeals, as shown by the evidence in the record. A number of items previously claimed were abandoned because of Respondents' conceded inability to prove them as losses.

On January 8, 1973, F & D filed a specific response to each item of loss claimed by the insureds, in which it specifically pointed out all evidence in the record which was relevant to such item of claim, and it gave its appraisal of the evidence in terms of proof of fraudulent or dishonest acts of employees and a resulting loss to the insured within the coverage of the bond, by applying the standards of law announced in the appellate court's decision.

On January 26, 1973, the District Court heard the case upon the items of loss set forth in the schedules filed by Hail Pool, Limited, and Pan Am, and upon F & D's response to each item of loss set forth in those schedules.

Throughout this entire litigation, and indeed at the trial before the District Court, Hail Pool, Limited, and Pan Am have alleged only that F. Wylly Clarke, Jr., acting alone or in collusion with other employees, did fraudulently or dishonestly embezzle, steal, divert, or otherwise misappro-

priate premium moneys on deposit with Hail Pool, Limited, and Pan Am, belonging to the pool participants and underwriters group.

There is no dispute about the fact that F. Wylly Clarke owned all of the stock in Hail Pool and Limited. Limited owned all of the stock in Pan Am. Hence, Clarke owned and controlled those three corporations. Clarke also owned a 50% stock interest in Halifax. Hail Pool, Limited, Management, and Halifax were all joint insureds under the bond throughout the period involved in this litigation.

On August 2, 1973, the District Court filed detailed findings of fact covering each item of claim asserted by Hail Pool, Limited, and Pan Am as an insured loss covered by the bond. The Court reviewed all the evidence in the record revelant to each item, and applied to it the principles of law prescribed in the decision of the Court of Appeals and the controlling law of Florida as to the burden of proof. It stated its conclusions of law on the findings, in which it held that, in accordance with the controlling Florida law, the burden was on Hail Pool, Limited, and Pan Am to prove all asserted acts of fraud or dishonesty by affirmative proof that is clear, cogent, and convincing, and that the burden was not on F & D to prove that the claimed loss to each insured corporation was not caused by acts of fraud and dishonesty covered by the bond.

The District Court further held that, when the claims asserted on behalf of Hail Pool, Limited, and Pan Am are considered in light of the evidence in the record and the controlling principles of law, it is clear that they cannot prove any affirmative acts of wrongdoing against the insured corporations, and they cannot meet the standards which have been established to govern disposition of the case. Finally, the District Court held that, on the evidence,

none of the claimants were entitled to recovery anything against F & D under the bond, and that the counterclaims were to be dismissed with prejudice. A judgment was entered on August 2, 1973, to dismiss all counterclaims on their merits, with prejudice (Appendix D, *infra*, at pp. D-1 to D-24). Hail Pool and Limited have never claimed in their appeal to the court below that the District Court's findings of fact, or any of them, are factually incorrect, or that they are not adequately supported by the evidence in the record. Nor does the Court of Appeals find the District Court's findings of fact to be incorrected or unsupported by the record evidence.

REASONS FOR GRANTING PETITIONER'S WRIT OF CERTIORARI

Petitioner is vitally interested in the Court's consideration of the Court of Appeals' erroneous disposition of the merits of its appellate contentions. The appellate court's opinion reflects a conscious disregard for its *Erie* mandate to ascertain and apply Florida substantive law in this diversity case. The resulting departure from the recognized role of the federal judiciary in our system of federalism encourages forum shopping and supplants applicable state law with federal common law that is wholly unsupported by policy or precedent.

However, Petitioner also recognizes this Court's understandable reluctance to reach otherwise meritorious issues of substance when a bona fide jurisdictional challenge is properly presented. Thus, without abandoning its substantial complaints to the merits of the Court of Appeals' decision, Petitioner is impelled to initially urge its challenge to the appellate court's jurisdiction in light of the

applicable Federal statutes and rules, the conflicting decisions of other circuits, and the overwhelming need for this Court to resolve this as yet undecided question of federal procedure that affects every litigant in the Federal courts.

I.

THE COURT OF APPEALS' AFFIRMANCE OF THE DISTRICT COURT'S VACATION AND REENTRY OF ITS ORIGINAL JUDGMENT UNDER THE ALLEGED AUTHORITY OF FED. R. CIV. P. 60(b)(6) FOR THE SOLE PURPOSE OF RESTORING AN OTHERWISE LOST RIGHT OF APPEAL MERITS REVIEW BECAUSE SUCH ACTION CONTRAVENES FED. R. CIV. P. 77(d), F.R.A.P. 4(a), AND 28 U.S.C.A. § 2107, AND IS IN DIRECT CONFLICT WITH THE DECISIONS OF OTHER CIRCUITS, AND ADDITIONALLY PRESENTS AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE SETTLED BY THIS COURT.

A.

The Holding of The Court of Appeals Is Contrary to the Express Provisions of F.R.A.P. (4a), Fed. R. Civ. P. 77(d), and 28 U.S.C.A. § 2107.

The facts upon which this ground for review by certiorari is sought are undisputed. F.R.A.P. 4(a) *infra,* at pp. 6-7, expressly requires that notice of appeal be filed within thirty days from rendition of the original judgment, unless, such time is extended for good cause shown for a maximum of an additional thirty days. The provisions of such rule were statutorily enacted at 28 U.S.C.A. § 2107, *infra,* at page 5. Rule 77(d), *infra,* at page 6, specifies that the lack of notice of the entry of a judgment by the clerk does not affect the time to appeal or relieve or authorize the court to relieve a party for failure to appeal within the time allowed, except as permitted in Rule 4(a) of the Federal Rules of Appellate Procedure. As previously noted that time period consists of a maximum extension of an additional thirty days. None of the respondents filed any notice of appeal until more than three months after the entry of the original judgment.

Timely filing of the notice of appeal is jurisdictional to the appellate court's review of the district court's judgment. Upon Respondents' discovery of their respective failures to timely file notice of appeal in accordance with the applicable rules and statutes, several Respondents moved for relief under the authority of Rule 60(b)(6) based solely on their failure to receive notice of the entry of the judgment in accordance with Rule 77(d). The District Court granted Respondents' requested relief by vacating its earlier judgment under the authority of Rule 60(b)(6) and reentering its original judgment for the sole purpose of restoring to Respondents their otherwise lost right of appeal. The Court of Appeals' affirmance of the District Court's action is diametrically opposed to the express language of Fed. R. Civ. P. 77(d), *infra* at page 6, which was specifically amended to preclude such action.

This court has consistently held the notes of the Advisory Committee to be entitled to weight in ascertaining the meaning and construction of the Federal Rules. *Mississippi Publishing Corp.* v. *Murphree,* 326 U.S. 438, 66 S.Ct. 242, 90 L. Ed 185 (1946). The notes of the Advisory Committee pertaining to the 1946 amendment of Rule 77(d) reflect

that such rule was amended in response to situations such as those arising in *Hill* v. *Hawes*. 320 U.S. 520, 64 S.Ct. 334, 88 L. Ed. 283 (1944).

The notes explain that *Hill* vested the district court with discretionary power and without time limit, to vacate a judgment and reenter it for the purpose of reviving the right of appeal when the clerk neglects or fails to give notice of the entry of a judgment to the respective parties. Because such action seriously impairs and affects the finality of judgments, the notes reflect that Rule 77(d) was amended to declare that notification by the clerk of the entry of a judgment does not suspend or extend the time for appeal. Notification by the clerk is intended as a mere convenience to the litigants and lack of such notification is expressly prescribed to have no effect upon the appeal time.

B.

FED. R. CIV. P. 60(b) DOES NOT EXPRESSLY OR IMPLIEDLY AUTHORIZE A DISTRICT COURT TO VACATE AND REENTER ITS JUDGMENT FOR THE SOLE PURPOSE OF REVIVING AN OTHERWISE LOST RIGHT OF APPEAL IN CONTRAVENTION OF FED. R. CIV. P. 77(d), F.R.A.P. 4(a) AND 28 U.S.C.A. § 2107.

Federal Rule 60(b) was enacted in 1946 contemporaneous with the amendment to Rule 77(d). The rule expressly provides, *infra* at page 6, that a filing of a motion under Rule 60(b) shall not operate to suspend or otherwise affect the running of time for appeal. Thus, by its own express language, Rule 60(b) was not designed and cannot be construed to vest in a district court any authority to restore to a losing litigant an already lost right of appeal in contravention of the applicable rules and statute.

The statutory counterpart of Rule 4(a), 28 U.S.C.A. § 2107 was adopted subsequent to the promulgation of Fed. R. Civ. P. 60(b).

The Advisory Committee's notes to Rule 60(b) reflect it derives, almost verbatim, from Calif. Code Civ. Pro., § 473. When a federal rule or statute derives from a state rule or statute, then such rule embraces the then existing interpretation and construction placed upon it by the state courts whose rule or enactment it is. Rule 473 appears in Title 6 of the Calif. Code Civ. Pro. which is entitled "Of the Pleadings in Civil Actions." It is part of Chapter 8 which is labeled "Variance, Mistakes in Pleadings and Amendments." The full caption to Calif. Code Civ. Pro. § 473 is "Amendments Permitted by Court; Enlargement of Time to Answer or Demur; Continuance, Costs; Relief from Judgment, etc., Taken by Mistake, Inadvertence, Surprise or Excusable Neglect; Clerical Mistakes in Judgment or Order; Vacating Void Judgment or Order." The California Supreme Court at the time of the federal enactment of Rule 60(b) had consistently interpreted Calif. Code Civ. Pro. § 473 to be limited in its application to judgments taken by default or otherwise when there had not been a trial upon the merits in the particular cause. *Jergins* v. *Schenck*, 162 Cal. 747, 124 P. 426 (1912). Toward the end of encouraging disposition of a suit on its merits, § 473 was consistently given a liberal construction.

On its face, such Rule was clearly not designed as a substitute for appeal or a means of restoring an otherwise lost right of appeal when there had been a disposition by a trial on the merits. The California courts have correctly cited to the appropriate section in Freeman, *A Treatise of the Law of Judgments* (5th ed. 1925) wherein such statutory enactments are discussed. Section 216, Freeman, *A Treatise*

of the Law of Judgments (5th ed. 1925) cites and discusses the California and similar statutes.

> "The statutes referred to in this section do not supersede the necessity for moving for a new trial in cases where a trial has been had, at which the parties seeking to have the judgment vacated were properly represented. If they were represented at the trial, they can obtain relief only by application made in conformity with the rules of procedure provided by law in reference to new trials. But if they were not at the trial, or were not represented there, on account of some mistake or excusable neglect, then their remedy is not by application for a new trial, but by an application addressed to the discretion of the court, and made under the statute authorizing relief to be granted from judgments rendered against a party through 'his mistake, inadvertence or excusable neglect.'"

Thus, Rule 60(b) as imported from Calif. Code Civ. Proc. § 473, was plainly not intended to apply to the facts presented in the instant case. Nor was Rule 60(b) of the Federal Rules so intended. Respondents have been represented throughout the litigation at bar which has resulted not only in a trial on the merits but also two previous appeals.

In rejecting Petitioner's Motion to Dismiss, the Court of Appeals cited and relied on its previous decision in *Smith v. Jackson Tool & Die, Inc.*, 426 F.2d 5 (5th Cir. 1970), which held that Rule 60(b) (6), authorized the Court's vacation of its judgment and reentry thereof for the purpose of reviving an otherwise lost right of appeal when there were additional circumstances besides the mere failure to learn of the entry of judgment. Petitioner contends that the *Smith* decision was an equally erroneous construction of Rule 60(b) (6) insofar as it purported to authorize a district court to vacate its judgment and reenter it for the

sole purpose of restoring a lost right of appeal in contravention of the applicable rules and statutes previously noted and argued.

Petitioner additionally argues, however, that the facts in *Smith v. Jackson Tool & Die* are markedly different from the facts at bar. In *Smith* the Court was faced with the District Court's inadvertent entry of a "proposed final judgment" after receiving an unopposed motion to refrain from entering such judgment for a 30-day period due to counsel's absence from the country. Counsel inquired upon his return and was informed that judgment had been entered without regard to the agreed motion to stay and counsel immediately applied for relief under Rule 60(b)(6). The Fifth Circuit initially conceded that the mere failure of the clerk to give notice of the entry of the judgment would not warrant the granting of Rule 60(b)(6) relief but held that in the circumstances presented, actions of the trial court had misled the party litigant to his detriment and authorized the granting of such relief.

By contrast, the record in the instant case reveals that the motion for Rule 60(b)(6) relief states only that all counsel had failed to learn of the entry of the judgment as a result of the clerk's failure to notify the interested counsel of the entry of judgment. The additional comments received at the hearing reflected that only three inquiries had been made of the court's law clerk as to the entry of judgment, and the clerk merely reassured inquiring counsel that the district clerk would notify them of the entry of judgment. The gratuitous reassurance by the Court itself, or through its representative, that the district clerk would fulfill its Rule 77(d) responsibilities constitutes nothing more than the mere failure of the clerk to notify the party litigants of the entry of judgment. Rule 77(d) clearly

requires each party litigant to continue to make inquiry relative to entry of judgment and Rule 60(b) relief cannot be afforded for the mere failure of the clerk to comply with that rule, regardless of reassurances. The burden is squarely placed on the parties litigant to ascertain and protect their rights without regard to any alleged justifiable reliance on reassurances from the court or its clerk that the district clerk would notify them. Were Rule 60(b)(6) interpreted to so readily override the plain provisions of F.R.A.P. 4(a), 28 U.S.C.A. § 2107, and Fed. R. Civ. P. 77(d), then any party litigant may ignore the applicable proscriptions by merely inquiring, "Are you sure the clerk will notify me?" and receiving the solicited affirmative reply. The Court further discusses the expectancy of appeal and lack of prejudice, but these criteria authorize obviating the Rules whenever a defendant wins a sizable lawsuit.

C.

The Court of Appeals' Decision Conflicts With Other Circuit Decisions that Deny a District Court's Authority Under Rule 60(b)(6) to Vacate and Reenter Its Judgment Solely to Restore an Otherwise Lost Right of Appeal.

The Court of Appeals' decision at bar directly conflicts with numerous other circuit courts' construction of the power vested in district courts by virtue of Rule 60(b) of the Federal Rules of Civil Procedure. Notably, *Hodgson v. United Mine Workers of America*, 473 F.2d 118 (D.C. Cir. 1972), holds, at 124:

> "It is well settled that there is no jurisdiction to hear appeals not filed within the time limit set by Rule 4(a) [Citing authority in footnote 29]. It is equally clear that motions filed under Rule 60(b) for relief from a judgment or order do not toll the time for filing a notice of appeal from such judgment or order. [Citing authority in footnote 30]. Nor can Rule 60(b) be used to circumvent time requirements by the simple expedient of vacating a judgment and reinstating an order to start a new the running of the appeal. [Citing and discussing authority at footnote 31].

The most cogent summation of the majority opinion of the circuits which have considered the district court's power to restore a lost right of appeal under Rule 60(b) appears in footnote 31 of the *Hodgson* opinion wherein the Court writes:

> "Weedon v. Gaden, *supra* note 29, 136 U.S. App. D.C. at 6 n. 31, 419 F.2d at 308 n. 31; Lord v. Helmandollar, *supra* note 27, 121 U.S. App. D.C. at 170, 348 F.2d at 782; Demers v. Brown, 343 F.2d 427, 428 (1st Cir.), cert. denied, 382 U.S. 818, 86 S.Ct. 40, 15 L.Ed.2d 64 (1965); Wagner v. United States, *supra* note 28, 316 F.2d at 872. The practice of vacating a judgment and then reinstating it for purposes of allowing time to file a notice of appeal was upheld by the Supreme Court in Hill v. Hawes, 320 U.S. 520, 64 S.Ct. 334, 88 L.Ed. 283 (1944). But in the 1946 amendment to Rule 77(d), the following sentence was added:
>
>> Lack of notice of the entry by the clerk does not affect the time to appeal or relieve *or authorize the court to relieve a party for failure to appeal within the time allowed,* except as permitted in Rule 4(a). (emphasis added).
>
> As the Advisory Committee Note to the 1946 amendment expressly states, its purpose was, in effect, to overturn Hill v. Hawes, *supra,* and the potential power it had given district courts to revive a right of appeal at any time. Advisory Committee Note to Fed.R.Civ.P. (77(d) (1946 amend.). See also Lord v. Helmandollar, *supra* note 27, 121 U.S. App. D.C. at 170, 348 F.2d at 782.

Additionally, the Court's decision conflicts with the contrary holdings in *Nichols-Morris Corporation* v. *Morris,* 279 F.2d 81 (2d Cir. 1962); *Lord* v. *Helmandollar,* 384 F.2d 780, 121 U.S. App. D.C. 168 (D.C. Cir. 1965), *cert. den.* 383 U.S. 928, 86 S.Ct. 929, 15 L.Ed.2d 874; *Sonnenblick-Goldman Corp.* v. *Nowalk,* 420 F.2d 860 (3d Cir. 1970); *Richland Knox Mutual Insurance Co.* v. *Kallen,* 376 F.2d 360 (6th Cir. 1967); *Files* v. *City of Rockford,* 440 F.2d 811 (7th Cir. 1971); *Brainerd* v. *Beal,* 498 F.2d 901 (7th Cir. 1974); and *Lathrop* v. *Oklahoma City Housing Authority,* 438 F.2d 914 (10th Cir. 1971), *cert. den.* 404 U.S. 940, 92 S.Ct. 132, 30 L.Ed.2d 73.

The Second Circuit in *Radack* v. *Norwegian American Line Agency, Inc.,* 318 F.2d 538 (2d Cir. 1963), specifically held that Rule 60(b) could not be used to circumvent the amendment to Rule 77(d), in regards to the effect of lack of notice on the running of the time for appeal.

Professor Moore, at 9 *Moore's Federal Practice,* (2d Ed. 1974), ¶ 204.13(2), pp. 977, 978, writes:

> "Rule 4(a) plainly says that the time for appeal may not be extended beyond the period of thirty days following its expiration. That means the request for an extension must be made and granted within the thirty-day period. There may be occasional cases in which that fact will work hardship, but to provide for such cases by rule that will cast doubt on the finality of judgments and increase the burdens of both district and courts of appeals seems unwise."

In *United States* v. *F&M Schaeffer Brewing Co.,* 356 U.S. 227, 230, 78 S.Ct. 674, 676-677, 2 L.Ed. 721 (1958), this court granted certiorari to consider the question of the date upon which a final judgment was entered so as to start the time for appeal. The Court granted certiorari to consider the asserted conflict among the circuits because of the public

importance of the proper interpretation and uniform application of the provisions of the federal rules governing the time in which appeals might be taken. To like effect is *United States* v. *Indrelunas,* 411 U.S. 216, 222, 93 S.Ct., 1562, 1565, 36 L.Ed.2d. 202 (1973). Petitioner submits that this Court has not, but definitely should consider and settle the question raised by the instant petition as to whether Rule 60(b)(6) can be used for the sole purpose of reviving an otherwise lost right of appeal in contravention of amended Rule 77(d), F.R.A.P. 4(a), and 28 U.S.C.A. § 2107.

This court's language in *United States* v. *Indrelunas, supra,* is particularly appropriate:

> ". . . A conflict on an issue such as this is of importance and concern to every litigant in a federal court . . ."

II

THE COURT OF APPEALS' DECISION MERITS REVIEW BY THIS COURT FOR THE FURTHER REASON THAT THE COURT OF APPEALS CLEARLY ERRED IN ASSUMING JURISDICTION TO REVIEW THE JUDGEMENT OF THE DISTRICT COURT WHICH DISMISSED THE COUNTERCLAIM FILED AGAINST PETITIONER BY RESPONDENT, PAN AMERICAN, LTD., AND IN VACATING THAT JUDGMENT, WHEN PAN AM FILED NO NOTICE OF APPEAL WHATSOEVER AS IS CLEARLY REQUIRED BY F.R.A.P. 4(a).

All courts which have previously considered the question have uniformly concurred that a court of appeals acquires jurisdiction of an appeal only upon the filing of a timely notice of appeal. It is apparent on the face of the appellate record in the court of appeals that Respondent, Pan Am,

filed no notice of appeal whatsoever and, as a consequence thereof, the Court erred in vacating that part of the judgment relating to Respondent, Pam Am, as the Court never acquired appellate jurisdiction in regards to the matters therein litigated. The judgment entered by the district court to dismiss Pan Am's counterclaim against petitioner, with prejudice, was final and conclusive and this Court should grant certiorari in order to additionally review that portion of the judgment which was vacated by the court of appeals as to Respondent, Pam Am, which filed no notice of appeal.

The Court of Appeals' willingness to accept and exercise its jurisdiction over Pan Am amply demonstrates the Court's predisposition toward the Respondents' appellate position on the jurisdictional and merits' points. In this regard, it is enlightening that the author of the opinion for the Court of Appeals had vigorously dissented from the holding in the first appeal that the fidelity bond in question did not directly cover the intervening owners of the premium accounts, either as insureds or as third party beneficiaries.

III.

THE COURT OF APPEALS' DECISION MERITS REVIEW BY THIS COURT BECAUSE IT: (1) CONSTRUED AN UNAMBIGUOUS INSURANCE CONTRACT; (2) HELD THAT THE RESPONDENT INSUREDS NEED NOT PROVE FRAUD OR DISHONESTY; (3) ELIMINATED THE CONTRACTUAL REQUIREMENT OF CAUSATION; AND (4) SHIFTED THE BURDEN OF PROOF TO THE INSURER TO "DISPROVE" AN INSURABLE LOSS UNDER THE FIDELITY BOND AND, THUS DECIDED IMPORTANT STATE QUESTIONS IN A MANNER SO AS TO CONFLICT WITH APPLICABLE STATE LAW AND FURTHER DISREGARDED THIS COURT'S DICTATES IN *ERIE V. TOMPKINS* AND ITS PROGENY.

The facts indisputably establish that the fidelity insurance contract at bar was delivered in Florida and was to be performed in Florida. Clearly the substantive law of the State of Florida must be applied in determining the rights and duties of the parties under the contract. *Lynch* v. *United States,* 292 U.S. 571, 54 S.Ct. 840, 78 L.Ed. 1434 (1934); *Erie Railroad Co.* v. *Tompkins,* 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938); *Clay* v. *Sun Insurance Office, Ltd.,* 363 U.S. 207, 80 S.Ct. 1222, 4 L.Ed.2d 1170 (1960).

Since federal jurisdiction in this case was predicated on diversity, the proper function of the district as well as the appellate court was to ascertain and apply the state substantive law. *Klaxon Co.* v. *Stentor Electric Mfg. Co.,* 313 U.S. 487, 61 S.Ct. 1021, 85 L.Ed. 1477 (1941). In recognition of this function, the courts of appeals have generally deferred to the district judges conclusions as to state law, especially when the federal district judge is a member of the bar of the state whose law is being determined. *Bernhardt* v. *Polygraphic Co.,* 350 U.S. 198, 76 S.Ct. 273, 100 L.Ed. 199 (1956).

In response to its *Erie* mandate, the district court filed detailed findings of facts and conclusions of law and after acknowledged consideration of the principles enunciated in the prior law of the case (Appendix B), rendered judgment for Petitioner. In contrast, the Court of Appeals vacated the extensive findings of fact and conclusions of law entered by the trial court without reference or citation to any applicabl· Florida authority. The Court of Appeals'

opinion marks a significant departure from applicable Florida substantive law which should have controlled the disposition of this cause. The essence of *Erie* is that federal adjudication in diversity cases should not differ from adjudication of a like controversy in the courts of the forum state.

At the outset, the Court of Appeals demonstrates a willingness to ignore the plain and unambiguous provisions of the insurance contract at bar in concluding:

> "It is obvious that the printed form of bond issued by Fidelity & Deposit simply does not fit the unusual circumstances of this case. F&D, knowing of these anomalies and knowing that issuance of such a bond in a situation as this was most unusual, walked into this loss with its eyes wide open." (Appendix A, *infra,* at page A-22).

It is significant that the District Court's first holding that the bond was a financial guarantee of the debts owed by the insured corporations to the pool participants in the underwriters group was reversed by the Court of Appeals in the first appeal wherein the bond was held to clearly not afford protection to the insureds' creditors (Appendix G at pages G-1 to G-17). It is illuminating that the writer for the majority in the instant appeal authored a dissent in the prior appeal and commented:

> "We do not have to prostrate ourselves before clear and unambiguous words when in the natural setting the words mean something more than they say." (Appendix G, *infra,* at page G-11).

Florida substantive law has long restrained judicial attempts to construe an unambiguous contract. In *Southern Home Insurance Co.* v. *Putnal,* 57 Fla. 199, 49 So. 922, at 930 (1909), the Court states:

> "In Atlantic Coastline R. Co. v. Beazley, 54 Fla. 311, Text 392, 45 South. 761, Text 787, we said:
>
> > 'All parties litigant who are sui juris, whether railroad corporations or their employees, in the eyes of the law, before the courts, stand upon equal footing, entitled to equal rights in protection and none to special privileges.'
>
> "We would now add insurance companies and the insured and that the persons insured, like railroad employees, cannot be said 'to be wards of the court.' We also held in the cited case, as in Scotts Mfg. Co. v. Carr, 53 Fla. 480, 43 South. 427 (1907); that parties are free to make what contracts they please, so long as no fraud or deception is practiced and there is no infraction of law. We further held that the fact that one of the parties made a rather hard bargain would not avoid the contract. This being true, and the plaintiff having accepted a policy from the defendant with such a clause or condition of the contract therein, why should not the defendant have the legal right, in an action brought against it on such policy, to base its defense on such provision?"

Indeed, the statutes of the State of Florida make provision regarding the construction of insurance policies. West's F.S.A. § 627.419(1) provides:

> "Every insurance contract shall be construed according to the entirety of its terms and conditions as set forth in the policy. . . ."

This Court has adopted a similar view in *Bergholm* v. *Peoria Life Ins. Co.,* 284 U.S. 489, 52 S.Ct. 230, 76 L.Ed. 416 (1932), in holding:

> "Contracts of insurance, like other contracts, must be construed according to the terms which the parties have used, to be taken and understood in the absence of ambiguity, in their plain, ordinary, and popular

sense. Imperial Fire Ins. Co. v. Coos County, 151 U.S. 452, 462, 463, 14 S.Ct. 379, 38 L.Ed. 231. . . . and to discharge the insured from the legal consequences of a failure to comply with an explicitly stipulated requirement of the policy, constituting a condition precedent to the granting of such relief by the insurer, would be violative of plain terms of a contract in utter disregard of long settled principles."

The Court of Appeals makes no pretense of finding ambiguity in the insuring provisions of the fidelity bond in issue, but instead proceeds to directly contradict the clear policy language in criticizing the district court's findings of fact and conclusions of law and noting:

> "We also note one statement of the district court in its conclusions of law that appears to be the source of much of its analysis of the specific claims. The court said that
>
> > 'In order to recover on the bond in this case, it is necessary to prove first of all that the employees committed fraudulent and dishonest acts which caused the insureds a loss.'
>
> "Neither the language of the bond itself, quoted above, nor the 1972 opinion requires causation per se as an element of recovery. The bond requires that there be a fraudulent or dishonest act and a loss to the insured corporations 'through' such an act. Good faith, if proved, might save some of the disbursements involved in the present case from the stigma of illegitimacy, but there does not have to be a finding of fraud or dishonesty with respect to every disbursement, viewed apart from the wrongful invasion of trust funds. If it were otherwise, one could hardly imagine a situation in which, given the circumstances involved here, an insurable loss could ever be shown.'" (Appendix A, *infra*, at page A-26).

The plain and ordinary meaning of the requirement to show a loss to the insured corporation's through such a dishonest and fraudulent act involves proof of causation. *Webster's International Dictionary* defines the word "through" to mean "by means of," and "by reason of." *Webster's* defines "by reason of" to mean "cause."

The only findings of fraud or dishonesty in the District Court's earlier opinion which was reversed in the Court of Appeals' second opinion related directly and specifically to diversion of premium moneys alleged to belong to the insureds' creditors. Those findings were effectively set aside by the Court, when the Court held that a loss to the insureds' creditors did not constitute a loss to the insured corporations who were the only insureds under the bond.

The Court continues with its emasculation of the law of the case enunciated in the Court of Appeals' second opinion when the Court dispensed with the necessity to prove the fraudulent and dishonest acts, eliminated contractually required causation and then, finally shifted the burden of proof in regards to the legality of the corporate expenditures of premium monies to the insurer. Thus, the Court has effectively shifted to the insurer the burden of "disproving" that an insurable loss was suffered by the insured corporations. Not only is Florida law to the contrary, but the law in every jurisdiction places the requirement and burden of proving a cause of action on an insurance contract upon the insured. That *Erie* requires the Court to apply the law of the forum with regards to burden of proof and presumptions has been the consistent position of this Court. *Dick* v. *New York Life Ins. Co.*, 359 U.S. 437, 79 S.Ct. 921, 3 L.Ed.2d, 935 (1959).

The substantive law of Florida which governs this cause clearly requires that in any case when fraud forms the foundation of a claim, under contract or tort, that

> "... fraud is never presumed and the burden of proof is on the party who asserts it, and fraud can be established only by clear and convincing evidence and that every one of the elements making up fraud must be clearly proven." Citing McGregor v. Provident Trust Co. of Philadelphia, 119 Fla. 718, 162 So. 323, at 333 (1935), Biscayne Boulevard Properties v. Graham, 65 So.2d 858, at 859 (Fla. 1953); Barrett v. Quesnel, 97 2d 706 (Fla. 1956)." (Appendix D, *infra,* at page D-20).

As previously noted, the Court of Appeals' earlier opinion (Appendix B) expressly held that the expenditure of so-called "trust" funds by the insured corporations did not constitute a loss under the bond and accordingly vacated the trial court's findings and judgment and remanded for specific determination by the trial court of whether the insured corporations could demonstrate an insured loss within the terms of the bond. In response to that previous opinion and mandate, the trial court made extensive findings as to the lack of any evidence to support a finding of illegality or illegitimacy in regards to the corporate expenditures of the diverted premium funds.

Without taking issue with the Court's findings on the failure of the respondent insureds to meet that burden, the Court instead creates a presumption of illegality of the corporate use of the diverted funds and shifts to the insurer for the first time, the burden of "disproving" that the insureds suffered a loss within the terms of the bond. This is accomplished by means of applying a pre-Erie decision, of this Court which deals with a presumed illegality in a minority shareholders' suit because of the alleged breach of faith of a director who acts in a fiduciary

capacity in regards to a challenged transaction with another corporation in which he had not disclosed that he was a director. No cases are cited, and understandably so, for the proposition that an insurer owes a similar fiduciary obligation in relation to its insured such as to require the creation of a similar presumption in favor of an insured loss. Thus, the Court of Appeals imposes upon the insurer a burden of proof which it has never had before, which no case law of any jurisdiction imposes upon it, and which is directly contrary to the applicable substantive law of Florida in suits of a similar character.

IV.

THE COURT OF APPEALS' DECISION MERITS REVIEW BY THIS COURT BECAUSE IT EFFECTIVELY MODIFIES AND REPUDIATES AN EARLIER OPINION OF THE COURT OF APPEALS WHICH CONSTITUTED THE LAW OF THE CASE AND, THUS, MANIFESTLY EXCEEDS THE COURT'S APPELLATE JURISDICTION SO AS TO CALL FOR AN EXERCISE OF THIS COURT'S POWER OF SUPERVISION.

As argued in the preceding section, the Court of Appeals' current opinion vitally modifies and substantially repudiates the law of the case earlier enunciated in the second opinion in the Court of Appeals. In violation of both the contract and that opinion, the Court relies solely on the District Court's earlier vacated findings of fraud and dishonesty as to the invasion of the so-called "trust" funds, strips the bond of its obvious causation requirement, and shifts the burden of proof to the insurer to "disprove" an insured loss within the terms of the bond. All holdings are contrary to the contract, the earlier opinion and the applicable substantive law of the State of Florida.

Even a cursory reading of the 1972 appellate opinion reflects that reversal was mandated because the insured had failed to discharge its burden of proving an insured loss under the bond. The only fraudulent acts ever alleged by the Respondents, or found by the trial court, related to the invasion of "trust" funds. The first appeal determined that the owners of the premium funds were neither insureds nor third party beneficiaries under the bond. The 1972 opinion expressly held that the mere invasion of "trust" funds would not establish a loss under the bond. There is no question that, as joint insureds, all of the premium monies were ultimately used to discharge legitimate corporate obligations owing to third party creditors.

The actual issue posed by the 1972 opinion on remand is whether the invaded premium funds were used in such a manner as to despoil the corporations as opposed to legitimate corporate purposes. By applying the "pierce the corporate veil" theory, in reverse, the Court of Appeals now assails the joint insureds' open and regular assumption of obligations for mutually legitimate corporate purposes. Clearly, none of the insured corporations are despoiled. Even if viewed as separate entities, the transactions between the related corporate insureds cannot properly be presumed illegal while simultaneously relieving the insureds of the necessity of proving fraudulent acts causing losses and covered by the bond. The Court of Appeals has created a new presumption of illegality on non-alleged acts of fraud while eliminating any causation requirements as to loss. Had this result been contemplated by the 1972 opinion, then that Court would not have remanded for new findings. It would have affirmed the earlier judgment based on this newly discovered presumption. Had these new acts of fraud been the basis for suit, then the Court's holding would amount to a conclusion that the bond covers

illegal *corporate* acts of the insureds. Florida law is clearly to the contrary as noted by Judge Dyer in his granting of a summary judgment for the insurer that was affirmed in *McKee* v. *Great American Insurance Company*, 316 F.2d 473 (5th Cir. 1973, per curiam).

Clearly, this Court of Appeals had no appellate jurisdiction to review and alter the determination of a coordinate panel of the same court. It has recently been held that one court of appeals panel may not review the decision of another panel of the same court which had denied a previous motion to dismiss an appeal. *Knapp* v. *North American Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974). The jurisdictional statute, 28 U.S.C.A. § 1291, clearly grants no authority for one panel of a court of appeals to review and materially alter the decision of a coordinate panel rendered some three years previous. Such action in and of itself represents such a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Honorable Court's power of supervision and consequent reversal.

V.

THE COURT OF APPEALS' OPINION MERITS REVIEW BY THIS COURT BECAUSE THE COURT OF APPEALS FAILED TO PROPERLY DISCHARGE ITS APPELLATE FUNCTIONS UNDER FED. R. CIV. P. 52(a) IN REVIEWING THE DISTRICT COURT'S FINDINGS OF FACTS AND CONCLUSIONS OF LAW AND SUBSEQUENTLY VACATING AND REMANDING SAID JUDGMENT FOR ADDITIONAL FINDINGS.

The Court of Appeals' opinion is wholly devoid of any finding of evidentiary inadequacy of the elaborate findings prepared and filed by the district court. What the District

Court found was the lack of evidence to support any insured loss.

This Court has granted certiorari to consider the question of whether the Court of Appeals properly discharged its appellate function under Rule 52(a), in *Zenith Corp.* v. *Hazeltine*, 395 U.S. 100, 123, 89 S.Ct. 1562, 1576, 23 L.Ed.2d 129 (1969), and defined the proper function of an appellate court upon review of findings of a district court in the following language:

> "In applying the clearly erroneous standard to the findings of the district court sitting without a jury, appellate courts must constantly have in mind that their function is not to decide factual issues *de novo*. The authority of an appellate court, when reviewing the findings of a judge as well as those of a jury, is circumscribed by the deference it must give to decisions of the trier of the facts, who is usually in a superior position to appraise and weigh the evidence. The question for the appellate court under Rule 52(a) is not whether it would have made the findings that the trial court did, but whether 'on the entire evidence [it] is left with the definite and firm conviction that a mistake has been made.' *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395, 68 S.Ct. 525, 542, 92 L.Ed. 746 (1948)."

Even a cursory reading of the Court of Appeals' opinion reflects that the Court wholly failed to discharge its proper appellate function in connection with these standards and totally ignored the applicability of Rule 52(a)'s mandate to reverse the district court's findings only if such findings are clearly erroneous.

The decision of the court below, in refusing to apply the "clearly erroneous" standard mandated by Fed. R. Civ. P. 52(a) is in direct conflict with the decisions of this court

in *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 394-395, 68 S.Ct. 525, 92 L.Ed. 746, 765-766 (1948); *McAllister* v. *United States*, 348 U.S. 19, 75 S.Ct., 6, 9, 99 L.Ed. 20 (1954); *Zenith Corp.* v. *Hazeltine*, *supra*. In all these cases, this Court held:

> "The question for the appellate court under Rule 52(a) is not whether it would have made the findings the trial court did, but whether on the entire evidence it is left with the definite and firm conviction that a mistake has been committed."

The only alleged mistake was the placement of the burden of proof on the insureds to prove an insurable loss as required by the Court of Appeals' 1972 opinion, the contract, and the applicable Florida substantive law. There being no mistake in that regard, the District Court's findings must stand unchallenged.

VI.

THE COURT OF APPEALS' OPINION MERITS REVIEW BECAUSE ITS SHIFTING THE BURDEN OF PROOF TO THE INSURER TO "DISPROVE" AN INSURED LOSS BY MEANS OF A NEWLY CREATED PRESUMPTION WITHOUT REMANDING THE CAUSE FOR A NEW TRIAL CONSTITUTES A DENIAL OF PROCEDURAL DUE PROCESS UNDER U.S. CONST. AMEND. V.

In all of the proceedings prior to the Court of Appeals' opinion, the respective party litigants had tried and appealed the issues in the case on the assumption that the insureds bore the burden of proving an insurable loss in order to establish their claims under the fidelity bond. The shifting of that burden to the insurer emanates initially and wholly from this latest court of appeals opinion. And

yet, the Court of Appeals merely vacates the findings and remands with instructions to the trial court to enter additional findings predicated on the evidence adduced at a previous trial wherein the insurer was not afflicted with the burden of "disproving" an insurable loss. Assuming, *arguendo,* (and certainly without conceding any of the previously urged points for review) that the Court of Appeals was possessed with appellate jurisdiction to modify the rights of the parties under the preexisting law of the case and applicable substantive law of the State of Florida in such a manner as was accomplished by this opinion, then such decision should have additionally granted Petitioner a right to retry the issues of the case in light of the new burden which has now been thrust upon it.

To deprive petitioner of its day in court to meet this new burden is to substantially deny it procedural due process of law as is guaranteed under the U.S. Const. amend. V. Such was the consideration by this Court in granting certiorari and requiring remand in accordance with procedural due process requirements imposed upon a state supreme court in *Saunders* v. *Shaw,* 244 U.S. 317, 37 S.Ct. 638, 61 L.Ed. 1163 (1917).

Hellis v. *Ward,* 308 U.S. 365, 60 S.Ct. 283 84 L.Ed. 327 (1939), is also substantially in point when the Court holds at 369:

> "The fact that the case was tried by the district court on an interpretation of the contract different from that of the circuit court of appeals is not per se sufficient to cause a remand for a new trial under the rule of Saunders v. Shaw, *supra.* The production of the well was tested by the umpire in the manner provided in the contract and the results of that test were, without objection, admitted at the trial. Complete establishment of the facts necessary for application of the formula was thus made in the manner provided by the parties in their contract. To be sure, petitioner now asserts that on a new trial he would attack the competency and accuracy of the umpire's report, matters which were immaterial to the issues on the trial in view of the fact that it was not contested that no more than 3,000 barrels of oil a day would be produced through a 3/8 inch choke."

The court in *Hellis* held that the petitioner had not presented that particular issue for review and thus affirmed. But nonetheless, the court clearly indicated that the rule of *Saunders* v. *Shaw* requires the granting of a new trial as an element of procedural due process when a new theory of a lawsuit is developed for the first time at the appellate level. This is most certainly true when the burden of proof is shifted from the party who bore it at trial to a new party on appeal. To require the trial court to make new findings of facts based on evidence adduced by the party opponent on the mutual (and now held erroneous) assumption that the burden was his, cannot sufficiently afford procedural due processs to the party litigant whose burden it has now become.

CONCLUSION AND PRAYER

WHEREFORE, premises, arguments and authorities considered, Petitioner respectfully requests that this Court grant his petition for writ of certiorari and upon full hearing hereof, reverse the Court of Appeals' decision and dismiss the appeal for want of jurisdiction, or alternatively reverse and remand to the court of appeals for determination and application of the proper law of the forum, or alternatively reverse and render or remand, and for such other

and further relief as the Court may feel Petitioner has shown itself justly entitled.

Respectfully submitted,
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that three true and correct copies of the foregoing was mailed by United States mail, postage prepaid, addressed to the following individual at the following address:

Thomas P. Cobb, Esquire
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By ....

APPENDIX A

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,
Plaintiff-Appellee,

v.

USAFORM HAIL POOL, INC., et al., etc.,
Defendants-Appellants.

DOCKET No. 74-1492

UNITED STATES COURT OF APPEALS,
FIFTH CIRCUIT.

NOVEMBER 20, 1975.

Various corporations in a corporate complex controlled by one dominant shareholder were insured by fidelity bond and the insurer brought action for declaratory judgment with respect to liability on the bond. A judgment for the defendants, 318 F.Supp. 1301, was vacated and remanded in part and affirmed in part, 463 F.2d 4. On remand, the United States District Court for the Middle District of Florida at Jacksonville, Charles R. Scott, J., made findings and entered judgment from which the insurer appealed. The Court of Appeals, Wisdom, Circuit Judge, held that the trial court had acted properly in vacating and reentering its judgment under rule authorizing relief from final judgments, so as to permit an appeal which had not earlier been timely taken. The Court then held that the burden was upon the insurer, seeking to defeat recovery on the bond, to establish the legitimacy of various payments and transfers by some of the corporations. The separate corporate existence of various corporations in the complex had been improperly disregarded in the district court's findings and conclusions and the issue was not whether

fraud had been established but whether certain payments and transfers satisfied legitimate obligations of the corporations making the payments or transfers.

Vacated and remanded.

1. Courts — 405(14.2)

Under rule providing that lack of notice of entry of judgment by clerk does not affect time to appeal or relieve or authorize courts to relieve party for failure to appeal within time allowed except as otherwise permitted by rule, untimely appeal is not permitted where there is mere failure to notify parties, but exception may be found in cases presenting mitigating circumstances or special hardships. Fed.Rules Civ.Proc. rules 60(b), 77(d), 28 U.S.C.A.; Fed. Rules App.Proc. rules 4(a), 60(b), 28 U.S.C.A.

2. Federal Civil Procedure — 2651

Where counsel diligently made suitable inquiries to discover status of case and district court assured counsel that his repeated inquiries were unnecessary and that counsel would be informed of entry of judgment and where case had been in progress for 12 years and an appeal by one side or the other was virtually certain, but counsel was not notified until after time for appeal had expired and where there was no prejudice to either side because neither side knew of entry of judgment, trial court acted properly in vacating and reentering judgment under rule authorizing relief from judgment. Fed.Rules Civ.Proc. rule 77(d), 28 U.S.C.A.; Fed.Rules App. Proc. rules 4(a), 60(b), 60(b)(6), 28 U.S.C.A.

3. Insurance — 430(2)

Where fidelity bond required fraudulent or dishonest act and loss to insured corporations "through" such an act, it

was not necessary that there be finding of fraud or dishonesty with respect to every disbursement, viewed apart from wrongful invasions of trust funds, nor was it necessary to show causation per se as an element of recovery.

4. Corporations — 1.4(2)

Corporate form will be disregarded when not to do so would work injustice upon innocent third parties.

5. Corporations — 1.6(1)

Where to disregard distinctive corporate identities would work injustice, corporate form would not be disregarded.

6. Courts — 406.9(15)

All findings and conclusions of district court in its first opinion not germane to issue on remand were binding upon district court.

7. Courts — 359.1(7)

State statutes and state common law afforded standards by which district court was to judge legitimacy of corporate disbursements which were basis of claims made against fidelity insurer. West's F.S.A. §§ 608.16, 608.18(6), 608.52, 608.54; 8 Del.C. §§ 154, 170, 242-244; Stock Corporation Law N.Y. § 58.

8. Insurance — 430(2)

Where there were various corporations in corporate complex controlled by one dominant shareholder and claim was made upon fidelity bond because of one corporation's assumption of assets of $110,000 and liabilities of $285,000 from another corporation, district court was bound to

consider such assumption from point of view of each corporation involved and to determine whether each satisfied legitimate corporate obligation in undertaking the transaction, and district court in so determining was to consider adequacy of consideration for such assumption of assets and liabilities. West's F.S.A. §§608.16, 608.18(6), 608.52, 608.54; 8 Del.C. §§ 154, 170, 242-244; Stock Corporation Law N. Y. § 58.

9. Insurance — 437.1(1)

Where there were various corporations in corporate complex controlled by one dominant shareholder and claim was made upon fidelity bond because of assumption of $110,000 of assets and $285,000 of liabilities by one corporation from another, it was appropriate to impose upon insurer, seeking to rely upon legitimacy of transaction, burden of proving it.

10. Insurance — 430(2)

Where there were various corporations in corporate complex controlled by one dominant shareholder and claim was made upon fidelity bond because of "advance" by one corporation to insurance agency characterized by district court as an "affiliated corporation," issue was whether particular advance fulfilled legitimate obligation owed by advancing corporation to the agency and not whether advance was necessary to keep agency afloat, despite contention that failure of one member of corporate complex would cause others to fail.

11. Insurance — 430(2), 437.1(1)

Where there were various corporations in corporate complex controlled by one dominant shareholder and claim was made upon fidelity bond because of advances received

by one insolvent corporation from another, insurer had burden of demonstrating propriety of the advances even though trial court found a practice of reciprocal advances between the affiliated corporations, which was a form of mutual assistance which was of long standing; issue was whether advancing insolvent corporation owed any legitimate obligation to the other insolvent corporation to make the advance. West's F.S.A. §§ 608.16, 608.18(6), 608.52, 608.54; 8 Del.C. §§ 154, 170, 242-244; Stock Corporation Law N.Y. § 58.

12. Corporations — 542(1)

Insolvency of corporation may make illegitimate some disbursements that otherwise might be legitimate, depending upon state statutory and common law. West's F.S.A. §§ 608.16, 608.18(6), 608.52, 608.54; 8 Del.C. §§ 154, 170, 242-244; Stock Corporation Law, N.Y. § 58.

13. Insurance — 430(2)

Where there were various corporations in corporate complex controlled by one dominant shareholder and claim was made upon fidelity bond because of disbursements made by one insolvent corporation to another, and it had earlier been established that funds used in such transactions were fraudulently and dishonestly diverted from their proper accounts, only remaining issue was whether obligation to which wrongfully appropriated money was applied was legitimate, i.e., whether particular insured corporation made disbursement to satisfy legitimate obligation owed to third party.

14. Corporations — 1.6(5)

Where there were various corporations in corporate complex controlled by one dominant shareholder and claim

was made upon fidelity bond because of disbursement of money by one insolvent corporation of the complex to another, court improperly lumped parent and subsidiary together for purposes of determining legitimacy of payments, where piercing of corporate veil would not prevent injustice to innocent third parties but rather would effectuate it.

15. Insurance — 437.1(3)

Where, in action upon fidelity bond issued to corporation, an amount appearing as a "loan receivable" on corporate balance sheet had appeared on previous balance sheet as due from a named employee, district court's finding that there was "no evidence" to show nature of loan and identity of borrower and thus no evidence of a payment which did not satisfy legitimate corporate obligation was erroneous.

16. Insurance — 437.1(3), 670

Where there were various corporations in corporate complex controlled by one dominant shareholder and claim was made upon such fidelity bond because of check drawn by one insolvent corporation to another in the complex, unrefuted testimony that corporation to which check had been drawn was dormant corporation which in its entire existence had only earned a few hundred dollars, transaction was at least questionable, and, in view of burden of proof upon insurer to show satisfaction of legitimate corporate obligation by the payment, recovery was improperly denied on the bond without specific findings on question whether disbursement went to satisfy legitimate obligation.

Appeal from the United States District Court for the Middle District of Florida.

Before MURRAH* and WISDOM, Circuit Judges, and GORDON, District Judge.

WISDOM, Circuit Judge:

This is the third appeal of this case. First, we held that representatives of individuals and companies doing business with various corporations in a corporate complex controlled by one dominant shareholder could not maintain an action as third party beneficiaries on a fidelity bond insuring those corporations. *American Empire Insurance Co. of South Dakota* v. *Fidelity & Deposit Co. of Maryland,* 5 Cir. 1969, 408 F.2d 72. This litigation focuses on the collapse of that corporate complex. In the second appeal we held that even though it was clear that the dominant shareholder had fraudulently diverted monies held in trust for these individuals and companies, that fact in itself did not make out a "loss" within the meaning of the bond. *Fidelity & Deposit Co. of Maryland* v. *USAFORM Hail Pool, Inc.,* 5 Cir. 1972, 463 F.2d 4. In this appeal, we hold, first, that we have appellate jurisdiction, and, on the merits, that the district court misapprehended the mandate of the 1972 opinion. Much as we regret the *Jarndyce* v. *Jarndyce see Shevolly* C. Dickens, Bleakhouse aspect of this case, we vacate the 1972 judgment and remand the case for further proceedings consistent with this opinion.

I

Fidelity & Deposit Co. (Fidelity) argues that this appeal must be dismissed for lack of appellate jurisdiction.

The district court held a hearing in compliance with the mandate of this Court on remand from the second appeal

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* Senior Circuit Judge of the Tenth Circuit, sitting by designation. Judge Murrah concurred in the above opinion before his death October 30, 1975.

of this case on January 26, 1973. The court took the case under advisement. About six months later, it entered an order dismissing the claims of the appellants against Fidelity on the merits with prejudice. On the same day, the clerk of the court entered the judgment on the docket. It is undisputed, however, that the clerk failed to notify any of the parties of the entry of the judgment, as the clerk is required to do by F.R.Civ.P. 77(d). This rule provides:

Notice Of Orders Or Judgments

> Immediately upon the entry of an order or judgment the clerk shall serve a notice of the entry by mail in the manner provided for in Rule 5 upon each party who is not in default for failure to appear, and shall make a note in the docket of the mailing. Such mailing is sufficient notice for all purposes for which notice of the entry of an order is required by these rules; but any party may in addition serve a notice of such entry in the manner provided in Rule 5 for the service of papers. Lack of notice of the entry by the clerk does not affect the time to appeal or relieve or authorize the court to relieve a party for failure to appeal within the time allowed, except as permitted in Rule 4(a) of the Federal Rules of Appellate Procedure.

On November 13, 1973, one hundred and three days after the judgment had been entered, counsel for the appellants learned of the entry of the judgment for the first time. On November 19, 1973, the appellants moved the district court for a new trial or, in the alternative, for judgment under F.R.Civ.P. 60(b), or for leave to file the notice of appeal instanter. On the same day, the appellants also filed a notice of appeal from the original judgment. On January 14, 1974, the district court, after a hearing, denied the motions for new trial and leave to file the notice of appeal instanter, but granted the motion for relief from judgment under F.R.Civ.P. 60(b), and entered an order vacating and

reentering its original findings of fact, conclusions of law, and judgment. On February 4, 1974, the appellants filed a second notice of appeal, this one from the newly entered judgment.

From the supplemental briefs this Court has requested on the point, it appears that after the hearing on January 26, 1973, counsel for the appellants diligently made repeated inquiries of the district court to determine whether judgment had been entered. The appellants' counsel made his last inquiry some time in July 1973. The court, through a member of its staff, informed him that no further inquiry should be made — because the clerk would notify the parties of the judgment when it was entered. In reliance upon this assurance, counsel did not inquire further. After several months had passed, however, counsel renewed his inquiry, and, for the first time, on November 13, 1973, was informed that judgment had been entered.

The third paragraph of F.R.App.P. 4(a) provides:

> Upon a showing of excusable neglect, the district court may extend the time for filing the notice of appeal by any party for a period not to exceed 30 days from the expiration of the time otherwise prescribed by this subdivision. Such an extension may be granted before or after the time otherwise prescribed by this subdivision has expired; but if a request for an extension is made after such time has expired, it shall be made by motion with such notice as the court shall deem appropriate.

This portion of F.R.AppP. 4(a), along with the final sentence of F.R.Civ.P. 77(d), was apparently intended to avoid the result reached in *Hill* v. *Hawes,* 1944, 320 U.S. 520, 64 S.Ct. 334, 88 L.Ed. 283. The 1946 advisory committee note to the amended F.R.Civ.P. 77(d) stated:

> In [*Hill* v. *Hawes*], an action instituted in the District Court for the District of Columbia, the clerk failed to give notice of the entry of a judgment for defendant as required by Rule 77(d). . . . [D]ue to lack of notice of the entry of judgment the plaintiff failed to file his notice of appeal within the prescribed time. On this basis the trial court vacated the original judgment and and then re-entered it, whereupon notice of appeal was filed. The Court of Appeals dismissed the appeal as taken too late. The Supreme Court, however, held that although Rule 77(d) did not purport to attach any consequence to the clerk's failure to give notice as specified, the terms of the rule were such that the appellant was entitled to rely on it, and the trial court in such a case, in the exercise of a sound discretion, could vacate the former judgment and enter a new one, so that the appeal would be within the allowed time.

See 7 Moore's Federal Practice ¶ 77.01[4].

[1] The primary concern of the advisory committee in proposing the amendment was that results such as those reached in *Hill* v. *Hawes* seriously affected the finality of judgments. The rationale of the amendment was to enhance the finality of judgments by placing the entire burden of determining whether a judgment had been entered upon the parties. Under amended Rule 77(d), they could place no justifiable reliance upon the fact that no notice of entry of judgment had been received from the clerk, but rather they were obliged to inquire periodically of the clerk or of the district court to determine whether judgment had been entered. The potential hardship to parties whose counsel, through inadvertence or lack of diligence, failed to learn of the entry of judgments is apparent. Less apparent is whether the benefit of enhanced finality outweighs these cases of hardship, and the burden on all concerned with respect to the periodic inquiries the amended rule implicitly contemplates. The courts, however, have generally enforced

F.R.Civ.P. 77(d) and F.R.App.P. 4(a) strictly according to their letter, regardless of the hardship involved. As this Court recently said in *In re Morrow,* 5 Cir. 1974, 502 F.2d 520, 523, "To permit an appeal where there is failure to notify, without more, would be opposed to the clear wording and intent of Rule 77(d)." *Morrow* finds support for its analysis in a number of earlier decisions in this and other circuits. *See, e. g., Jackson* v. *Decker,* 5 Cir. 1971, 451 F.2d 348; *Lord* v. *Helmandollar,* D.C.Cir. 1965, 348 F.2d 780; *Richland Knox Mutual Ins. Co.* v. *Kallen,* 6 Cir. 1967, 376 F.2d 360; *Nichols-Morris Corp.* v. *Morris,* 2 Cir. 1962, 279 F.2d 81; *Sonnenblick-Goldman Corp.* v. *Nowalk,* 3 Cir. 1970, 420 F.2d 858; *Files* v. *City of Rockford,* 7 Cir. 1971, 440 F.2d 811; *Lathrop* v. *Oklahoma City Housing Auth.,* 10 Cir. 1971, 438 F.2d 914.

An exception, however, has grown up in cases presenting mitigating circumstances or special hardships. In *Smith* v. *Jackson Tool & Die, Inc.,* 5 Cir. 1970, 426 F.2d 5, the district court had circulated its opinion to the parties before entering judgment. Counsel for the appellant, upon reviewing the opinion, requested the court to delay entering final judgment because he would be away from town on a trip. Opposing counsel was notified of this request, and informed the court that he had no objection to a delay in entering judgment. The parties also informed the court that an appeal would be taken. The court, however, did not respond to this request for a delay in entering its judgment, but proceeded to enter the judgment thirteen days after sending the opinion to counsel. Moreover, the court did nothing to advise counsel that the request for delay was being denied. Counsel for the appellant learned of the entry of judgment only after the time for filing notice of appeal had expired. He promptly moved that the judgment be vacated, and the district court, apparently realizing that its treatment of the

matter had led counsel to believe that there would be a delay in entering judgment, granted the motion, relying on F.R.Civ.P. 60(b), which provides:

> *Mistakes; Inadvertence; Excusable Neglect; Newly Discovered Evidence; Fraud, Etc.* On motion and upon such terms as are just, the court may relieve a party or his legal representative from a final judgment, order, or proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence which by due diligence could not have been discovered in time to move for a new trial under Rule 59(b); (3) fraud . . . misrepresentation, or other misconduct of an adverse party; (4) the judgment is void; (5) the judgment has been satisfied, released, or discharged . . .; or (6) any other reason justifying relief from the operation of the judgment . . . . A motion under this subdivision (b) does not affect the finality of a judgment or suspend its operation. This rule does not limit the power of a court to entertain an independent action to relieve a party from a judgment, order, or proceeding, or to grant relief to a defendant not actually personally notified as provided in Title 28, U.S.C., § 1655, or to set aside a judgment for fraud upon the court.

This Court in *Jackson Tool & Die* said that the policy of finality must on occasion give way to unusual circumstances, including lack of prejudice to one party and prejudice to the opposing party. We noted that more was involved in *Jackson Tool & Die* than in the usual case involving the simple failure (however inexcusable) of the clerk to notify the parties of the entry of judgment. The additional factors we noted were that the appellees could not assert surprise at the appellant's desire to appeal the decision, since the parties had already indicated to the court that the judgment would be appealed. Nor was there any prejudice to the appellees, because they had not been notified of the entry of judgment, and of course could not maintain that they

relied upon it. In light of the fact that the litigation in *Jackson Tool & Die* had stretched over nine years preceding the entry of judgment, we reasoned that a further extension of time for appeal of a few days in itself would work no prejudice upon the appellees. Finally we noted that the trial judge was well aware of the fact that the parties did not anticipate that he would enter judgment, and, because he had received correspondence with them after entering judgment, that they had not been informed that the judgment had been entered. Because of this apparent reliance on the district court, we held that his later order vacating and reentering judgment under F.R.Civ.P. 60(b)(6) was not an abuse of discretion but was in full acord with the spirit of the rule and with the more general precept that we must construe the Federal Rules of Civil Procedure liberally so as to promote rather than thwart the ends of justice.

More recently, the District of Columbia Circuit considered the problem in *Expeditions Unlimited Acquatic Enterprises, Inc.* v. *Smithsonian Institute,* 1974, 163 U.S.App.D.C. 140, 500 F.2d 808. The district court, unknown to either of the parties, had entered summary judgment in one of two cases between the parties pending before it. The parties engaged in discovery with respect to the second suit, and ten months elapsed between the entry of judgment and a conversation between the trial court's law clerk and counsel for the appellant in which counsel learned of the entry of judgment. He moved that the trial court vacate the judgment and reenter it so as to preserve the right to appeal, but the court denied the motion. On appeal, the District of Columbia Circuit reversed the district court. It reasoned that F.R.Civ.P. 60(b)(6) justified this form of relief from judgment. It cited *Klapprott* v. *United States,* 1949, 335 U.S. 601, 69

S.Ct. 384, 93 L.Ed. 266, for the proposition that the provision "vests power in courts adequate to enable them to vacate judgments whenever such action is appropriate to accomplish justice." Recognizing the line of authorities under F.R.Civ.P. 77(d) holding that the mere negligence of the clerk did not excuse the parties from failure to file a timely notice of appeal, the court concluded that since "this rule is intended to preserve the finality of judgments," "if the parties do not know of the entry of judgment, the winning party cannot rely on the judgment and the losing party cannot make a 'free, calculated, deliberate' choice not to appeal. . . . In these circumstances the purposes behind Rule 77(d) would not be served by denying the losing party the privilege of appealing . . . ." 500 F.2d at 809. The court distinguished some of the earlier cases decided under F.R.Civ.P. 77(d) on the ground that in those cases "counsel knew of the entry of judgment in time to perfect an appeal under the Rules." 500 F.2d at 809. The court said:

> We believe that a trial court may vacate and re-enter a judgment under Rule 60(b) to allow a timely appeal when neither party has actual notice of the entry of judgment, when the winning party is not prejudiced by the appeal, and when the losing party moves to vacate the judgment within a reasonable time after he learns of its entry.

The court cited *Jackson Tool & Die* with approval in this regard.

[2] In the present case, as in *Expeditions Unlimited and Jackson Tool & Die*, none of the parties knew of the entry of judgment, and none could be said to have relied upon it. In this case, as in *Jackson Tool & Die,* the trial court had been in communication with counsel for the appellant regarding when judgment would actually be entered. In both cases counsel diligently sought to discharge the duty implicit in F.R.Civ.P. 77(d) to make suitable inquiries to discover for itself the status of the case. Indeed, there is an additional element in the present case. Here, unlike the mere failure of the district court in *Jackson Tool & Die* either to postpone entering judgment or to respond to counsel's letters, the district court assured counsel that his repeated inquiries were unnecessary (and, possibly, were beginning to seem repetitious), and that counsel would be informed of the entry of judgment. Moreover, in the present case there was a virtual certainty than an appeal would be taken. This case had been in progress for twelve years, and had been before this Court twice before. The issue then before the district court was a relatively narrow one on which the sides were, as appellants note, "diametrically opposed". An all-or-nothing judgment in the neighborhood of $1,000,000 was at stake, and, as appellants point out, "there was no conceivable way that the district court could have entered a judgment which would not have resulted in another appeal to this Court by one side or the other."

In these circumstances, more is involved than the mere failure of the clerk to discharge his duty under F.R.Civ.P. 77(d). There was no prejudice to either side, because neither side knew of the entry of judgment. Counsel promptly filed notice of appeal after the action of the district court vacating and reentering its judgment. Indeed, counsel at all times acted diligently, and relied upon an express assurance from the district court that they need not continue their inquiries. The case had been fought long and hard, and an appeal by one side or the other was virtually certain. We hold that the trial court acted properly in vacating and reentering its judgment under F.R.Civ.P. 60(b).

II

This diversity suit began on August 30, 1963, when Fidelity filed its complaint seeking a declaratory judgment to have its liability determined on a fidelity bond it had issued to certain insured corporations forming parts of the corporate complex. F. Wylly Clarke dominated. The first appeal in this case was taken from the action of the district court granting partial summary judgment in favor of Fidelity and against two insurance companies that had intervened as class representatives for the participants in the hail insurance pool and for underwriters who were claiming reinsurance premiums and return premiums from the insured corporations. The insurance companies in the hail pool insured losses to farmers caused by hail storms; they accepted the risk and apportioned profits on a pro-rata basis. The question in the first appeal was primarily one of construction of the bond. This Court held that the intervenors were not third party beneficiaries of the bond. *American Empire Ins. Co. of South Dakota* v. *Fidelity & Deposit Co. of Maryland,* 5 Cir. 1969, 408 F.2d 72. That disposition is not challenged here.

On remand, the case proceeded to trial and judgment. The trial court rendered a carefully considered opinion and made findings of facts, many of which govern the present appeal. *Fidelity & Deposit Co. of Maryland* v. *USAFORM Hail Pool Inc.,* M.D.Fla.1970, 318 F.Supp. 1301. There was no substantial dispute regarding the facts. Indeed, counsel agreed on extensive pre-trial stipulations. For clarification, re reproduce in the margin a diagram of

the relationships among the corporations[1]. This, the parties stipulated, was accurate.

We must also summarize here the findings of the district court in that opinion relevant to this appeal. The insuring agreement given by Fidelity in the bond provided:

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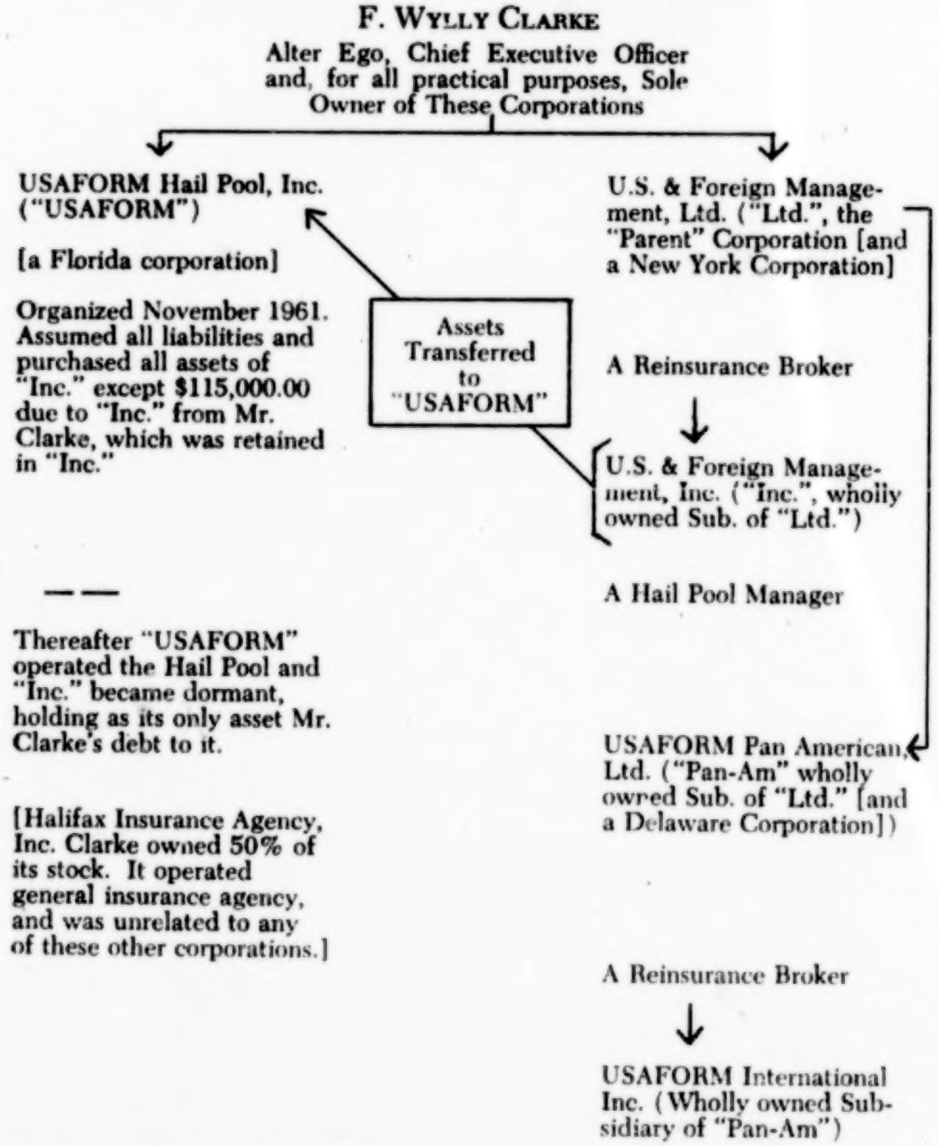
1 **DIAGRAM OF CORPORATE RELATIONSHIPS AS STIPULATED BY THE PARTIES***



*Matter in brackets has been added by this Court.

> The Underwriter [Fidelity], in consideration of the payment of the premium, and subject to Declarations made a part hereof, the General Agreements, Conditions and Limitations, and other terms of this Bond, agrees to indemnify the Insured against any loss of money or other property which the Insured shall sustain through any fraudulent or dishonest act or acts committed by any of the Employees, acting alone or in collusion with others, the amount of indemnity on each of such Employees being the amount stated in Item 3 of the Declarations.

The claimants in the present appeal are three of the corporations named in the bond and riders as insureds. They are USAFORM Hail Pool, Inc. ("USAFORM"), a hail pool manager; U.S. & Foreign Management Ltd. ("Limited"), the parent corporation, a reinsurance broker; and USAFORM Pan American Ltd. ("Pan-Am"), a reinsurance broker. Their claims are based upon a number of alleged fraudulent and dishonest acts by F. Wylly Clarke, who, as the parties stipulated, was the "alter ego", chief executive officer, and for all practical purposes sole owner of the insured corporations.

The district court described the operations of the three corporations as follows:

> USAFORM was organized in November of 1961. During its first and only crop year, 1962, it acted as manager of a pool created by certain insurance companies (pool participants) to cover hail storm damage to crops owned by farmers who were insureds of these pool participants. USAFORM collected the insurance premiums for the pool participants and deposited the premiums in a segregated trust account which belonged to the participants. Under the pooling arrangement, USAFORM was to pay, on behalf of the pool participants, losses to farmers and expenses of the pool, deduct its commissions, and, at the end of the pool's operating year, remit the balance in the premium account to the participants. Thus, each pool year was a self-contained operation, commenced and completed in one year and involving only one growing season. The function of USAFORM was that of a manager and it sold no insurance of its own.
>
> Limited and Pan-American likewise sold no insurance but acted as intermediaries between insurance companies desiring to reinsure or "cede" portions of their liability under insurance policies and insurance companies desiring to reinsure portions of the liability under such insurance policies. The reinsurance premiums payable to the reinsuring companies were delivered to Limited and Pan-American for transmittal to the reinsuring companies. By reason of the numerous transactions, there was a constant balance of such reinsurance premium monies on deposit with Limited and Pan-American. These premium monies belonged to the insurance companies (underwriters group) doing business with Limited and Pan-American. Under Sections 125 and 5, Insurance Law, Volume 27, McKinney's Consolidated Law of New York, c. 28, . . . which governed the operation of these two companies, premium monies received by Limited and Pan-American were held in a fiduciary capacity, and were required to be deposited in an account separate from the corporation's own funds. Violation of this anti-commingling section is a crime.

The district court carefully stated the issues of fact and law before it for decision as follows:

> 1. Whether fraudulent or dishonest acts were committed by employees of the insured corporations, within the meaning of those terms as used in the bond, and if so, by whom.
>
> 2. Whether the losses resulting from Clarke's actions were such losses as are contemplated by the bond.
>
> 3. Whether the fact that Clarke was the alter ego of the insured corporations eliminated F. & D.'s liability for loss occasioned by Clarke's dishonesty.

4. If the insured corporations had "officers" other than Clarke within the meaning of the bond, (i) whether these "officers" had knowledge of Clarke's dishonesty, and if so (ii) whether these other "officers" acted in collusion with Clark . . . .

5. The amount of coverage furnished by the bond.

6. The amount of interest to be allowed to claimants.

With respect to the first issue, the trial court observed that USAFORM during the period in question here held in trust around $4 million, and that this money could be disbursed by it only in one of several carefully defined ways. The court found: "[T]he transfers from the [USAFORM trust account] of approximately $418,000.00 made by Clarke or his employees at his direction, during a time when USAFORM was insolvent, were dishonest and fraudulent invasions by Clarke of a trust fund clearly belonging to the pool participants and amounting to a loss protected by . . . the bond. These wrongful acts were willful and flagrant violations of the fiduciary duty that was owed [to] the pool participants." 318 F.Supp. at 1306.

The Receiver appointed for USAFORM calculated the shortage in the pool participants' trust account at $311,624.58, and, accordingly, the court awarded this entire amount. Similarly, the court found that there was an invasion in excess of $500,000 of a trust account held by Limited, and that this constituted "a dishonest and fraudulent invasion of a trust fund clearly belonging to the underwriters with whom Clarke dealt . . .." 318 F.Supp. at 1307. The court made parallel findings with respect to Pan-Am, finding that there was a "dishonest and fraudulent invasion of a trust fund clearly belonging to the underwriters" to the extent of approximately $50,000. *Id.*

Addressing itself to the second issue, whether the losses sustained by the corporations were losses compensable under the bond, the district court summarized Fidelity's argument this way:

> F. & D. [Fidelity] contends that as these funds were withdrawn from premium accounts and applied to "proper corporate purposes," and as all such transactions were properly recorded on the books of account of the various corporate insureds, no "loss" within the coverage and meaning of the bond occurred.

The district court held that the unauthorized transfers from the trust accounts were covered by the bond. The court did not address the issue of whether the uses to which the wrongfully transferred funds were put were "legitimate" or "proper" corporate purposes. This turned out to be the only issue upon which we remanded the case to the district court in our 1972 opinion.

On the third issue, the court held that Clarke, even though he was the "alter ego" of the insured corporations, was a covered employee under the terms of the bond. The court boldly stated that "Clarke stole the only thing that he could steal — money that his wholly owned corporations held in trust for others." 318 F.Supp. at 1309. But, the court noted, Fidelity "knew everything about Clarke's operation, including his stock ownership and the fact that he would be managing large sums of money belonging to others; that Clarke controlled the named insured corporations and that he was the only one in [a] position to misappropriate a substantial sum of money." *Id.*

On the fourth issue, the court noted that Fidelity "knew when it wrote the bond that in the event of fraud by Clarke, there was no one to whom it could look or upon whom it could rely to give notice of such misconduct" and that Fidelity "also knew that the only person who could steal

anything of consequence was Clarke". 318 F.Supp. at 1309. Therefore, the court reasoned, Fidelity "waived the knowledge and discovery provisions of their bond insofar as Clarke himself was concerned." 318 F.Supp. at 1310. Moreover, the parties had stipulated that Clarke was covered by the bond and that the bond was in full effect at all relevant times. Finally, the court stated:

> It is . . . obvious that the printed form of bond issued by F. & D. simply does not fit the unusual circumstances of this case. F. & D., knowing of these anomalies and knowing that issuance of such a bond in a situation such as this was most unusual, walked into this loss with its eyes wide open.

318 F.Supp. at 1312.

The court's findings on the extent of the bond's coverage and on interest do not concern us here.

On appeal, this Court held that the district court had "used the wrong standard of law in determining the *amount of liability* on the bond", and reversed on that ground. *Fidelity & Deposit Co. of Maryland* v. *USAFORM Hail Pool, Inc.*, 5 Cir. 1972, 463 F.2d 4 (emphasis added).

Because some of the language in this opinion may have proved confusing to the district court on remand, we must examine it carefully here:

> We hold that the taking of money from the premium account of an insured company to pay other *legitimate* obligations *of that company* does not constitute a loss within the meaning of the fidelity bond before us in this case. Since the findings of the district court were not addressed specifically to the question of whether funds taken from the insured companies' premium accounts went to pay *legitimate expenses of the respective companies*, we vacate the judgment . . . and remand the case for further consideration and the entry of additional findings of fact. It goes without saying that any funds diverted to the *personal use of the employees*, to *other* corporations *without legal claims*, or for any purpose at all that was *not for a legitimate corporation purpose* would represent a loss *to the corporation*, and the claimants would be able to recover for such amounts. . . . We have carefully reviewed all other grounds asserted by appellant and affirm the district court *in all other respects*.

463 F.2d at 7 (emphasis added).

In explaining this holding, this Court implied that the district court had not gone far enough. That court had examined the process by which the premium or trust counts had been depleted; it had not examined the use to which the wrongfully appropriated monies from the premium or trust accounts were applied. This Court noted that the "bond was written to protect against loss to the *insureds*, not the losses of third parties." 463 F.2d at 5 (emphasis added). To illustrate this point, this Court said: "[T]he case must be viewed as if the insured companies were solvent and had adequate funds in their general accounts to replace the money diverted from the premium accounts. If the insureds cannot recover on the bond in that situation, their insolvency does not improve their case against the bonding company." 463 F.2d at 5-6.

This illustration may have caused confusion in the proceedings on remand. All that this Court said was that a loss is not made out merely by showing that funds were wrongfully diverted from one account within a corporation and applied to another account within that same corporation. We did not mean to imply that the insolvency of the corporation was wholly irrelevant to the district court's task on remand. On the contrary, in certain circumstances insolvency would be highly relevant to and possibly deter-

minative of the question whether a particular disbursement was made for a legitimate corporate obligation. Later in the opinion, in fact, we noted such a case. *Franklin Savings & Loan Co. of Macon* v. *American Employers Insurance Co.,* 5 Cir. 1938, 99 F.2d 494, involved a payment of dividends in preference to corporate debts to shareholders in violation of state corporate law, which permitted the payment of dividends only out of net earnings as defined by the statute. The statutory provision was intended in part to protect creditors by preventing payments to shareholders in preference to debts to creditors. It is not clear whether the corporation involved in *Franklin* was "insolvent,[2] but, in light of our focus in *Franklin* on whether the payments were legal under state corporate law, the insolvency of a corporation is properly taken into account in a case of this nature when state corporate law prohibits certain sorts of payments by a corporation which is insolvent.

Another possible source of confusion was this Court's statement that in this case, before the diversion of the trust funds, the claimants owed legitimate corporate obligations to third parties." 463 F.2d at 6. In our earlier opinion this Court did not mean to imply that every one of the "obligations" paid by the wrongfully appropriated premium monies was indeed legitimate: that was the very question to be determined upon remand. The same is true of the reference in the opinion to using "'trust' funds to pay legitimate corporation obligations". 463 F.2d at 5. This Court was posing the question, not stating the conclusion to be reached on remand.

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[2] The term may have acquired a specific and somewhat technical definition under the statutory or common law of a particular state. In the absence of such special definition, it usually means the inability of the corporation to meet its debts as they fall due, or an excess of corporate liabilities over assets.

A third possible source of some confusion was this Court's reference to the holding of the Fourth Circuit in *Kerr* v. *Aetna Casualty & Surety Co.,* 4 Cir. 1965, 350 F.2d 146, that "neither wash transactions nor frauds on creditors make out insured losses" under the bond involved in that case. We did not pause to define what sorts of transactions were comprehended within the loose term "wash transactions." The term, of course, is frequently used to characterize a "sale" of a security or commodity in which there is no transfer of beneficial ownership, the transaction being undertaken for some ulterior motive such as the manipulation of market prices. For example, in the *Kerr* case, the questioned transaction "to make a financial statement of one of the insured corporations look better and so mislead or deceive the Insurance Commissioner or a bank which was considering a loan," but it was not for the purpose of deceiving or despoiling the insured corporations. 350 F.2d at 150. The reference to "wash transactions", with the language just quoted, might be taken to imply that in a case involving a group of corporations related by common ownership, transactions among the corporations are not protected by the bond unless the net financial condition of all of the corporations considered together as one were impaired. Our holding in the earlier appeal, however, which we have quoted above, dispels any such notion when carefully read. It fairly indicates that each corporate tub must stand upon its own bottom. This follows from the reference to "the taking of money from the premium account of an insured company to pay other legitimate obligations *of that company.*" 463 F.2d at 7. In the next sentence, we referred to the "legitimate expenses of *the respective companies.*" *Id.* The district court in its first opinion had carefully analyzed the claimants' position on a company-by-company basis. 318 F.Supp. 1301. That approach was in no way challenged by this Court; rather,

we took care to state that the district court's determination was affirmed in all other respects. 463 F.2d at 7. In citing *Kerr*, this Court did not mean to exempt "wash transactions" or "frauds on creditors" from the test to be applied to other transactions: did the corporation making the challenged disbursement owe a legitimate corporate obligation to the corporation or individual receiving the payment?

[3] We also note one statement of the district court in its conclusions of law that appears to be the source of much of its analysis of the specific claims. The court said that "in order to recover on the bond in this case, it is necessary to prove first of all that the employees committed fraudulent and dishonest acts which caused the insureds a loss." Neither the language of the bond itself, quoted above, nor our 1972 opinion requires causation per se as an element of recovery. The bond requires that there be a fraudulent or a dishonest act *and* a loss to the insured corporation "through" such an act. The findings of fraud and dishonesty were clear and pervasive in the district court's first opinion, and they were affirmed in our 1972 opinion. The issue on remand was loss — whether the wrongfully appropriated monies went to pay legitimate corporate obligations (in which case there would be no "loss") or whether they were made for any other purpose (in which case there would be a "loss'). Good faith, if proved, might save some of the disbursements involved in the present case from the stigma of illegitimacy, but there does not have to be a finding of fraud or dishonesty with respect to every disbursement, viewed apart from the wrongful invasions of trust funds. If it were otherwise, one could hardly imagine a situation in which, given the circumstances involved here, an insurable loss could ever be shown.

On the facts, *General Finance Corp.* v. *Fidelity & Casualty Co. of New York*, 8 Cir. 1971, 439 F.2d 981, is a case

that is very close to the one before us now. Counsel for Fidelity conceded in the earlier appeal that the fidelity bond involved in *General Finance* is identical with the bond involved in this case. In *General Finance*, one individual, Leach, was the president of a group of related, closely-held corporations. He and his wife held the majority of the stock in one of these corporations. The Eighth Circuit, through Mr. Justice Clark, noted that "the overall scheme according to the [claimant] is that Mr. Leach raided [one of the insured corporations] to aid other corporations in the complex." 439 F.2d at 985. Part of the claim in *General Finance* was based upon transfers from GFC, one of the insured corporations, to Dakota Mutual, which had an agreement for Dakota Underwriters to pay all the "operating and administrative expenses" of the former. Dakota Underwriters, in turn, was owned in substantial part by GFC. Leach was president of all the companies. GFC, at the instance of Leach, issued checks payable to Dakota Underwriters but deposited in Dakota Mutual's bank account. Mr. Justice Clark summarized the argument and holding respecting these transactions as follows:

> The records indicate that the advancements were marked on the books of GFC as unsecured loans. The [bonding company] claims that this loss was due to poor business judgment rather than to acts of fraud or dishonesty. However, the loans or advancements violated the by-laws of GFC requiring the Board of Directors to approve loans in excess of $5,000. Moreover, the action of Mr. Leach in this regard followed a familiar pattern of taking money from GFC to bail out other failing companies. Indeed, the money was advanced when GFC itself was in a deficit condition. Mr. Leach's action in this regard, being fraudulent, was covered by the bond.

439 F.2d at 985.

Another portion of the claim in *General Finance* was based upon allegedly improper payments of dividends. The court noted that the payments of dividends were indeed improper under general principles of state corporate law which prohibit such payments at a time when a corporation is in a "deficit position". Because Leach and his wife owned a majority of the stock, the improper payments of dividends rebounded primarily to their benefit. The court held that the improper payments were losses to the insured corporation compensable under the bond, because the bond specifically covered the actions of directors who were also officers, and Leach's actions in authorizing the payments could be characterized as those of a director in that position. There were, in addition, a number of other transactions by which monies were transferred from GFC to related corporations. Because of the monetary limit of the bond, the court found it unnecessary to pass upon whether these transactions qualified as losses within the meaning of the bond. Rather, it reversed the district court and entered judgment for the full amount of the bond in favor of the claimant based upon the advancements GFC made to pay Dakota Underwriters' debts and upon the improper payments of dividends to GFC's shareholders.

Here we think it appropriate to pause and restate some of the fundamental tenets of state corporate law, in addition to the principles stated in *General Finance,* that govern in a situation such as that involved in the present case. The bird's-eye view of the corporate network that the diagram reproduced in footnote 1 affords must not be allowed to obscure the individual and independent roles each particular corporation played vis-a-vis the general public. The companies and the individuals with whom each insured corporation in this network dealt perceived the corporation as standing alone. Farmers seeking to insure their

crops dealt with the hail pool manager as a trusted intermediary between them and the insurers underwriting the risk; they did not perceive it as simply another mask worn by an "alter ego" named F. Wylly Clarke. The same is true of those firms dealing with the reinsurance broker who sought to reallocate the risks they underwrote. Indeed, certain third parties went so far as to inquire of Fidelity, through Clarke, as to whether the fidelity bond covered the monies held in trust for them, and were informed by Fidelity, again by a letter to Clarke, that these monies were covered by the bond.

[4.5] This is not the place to catalogue the many and varied instances in which courts of equity have disregarded the corporate form—pierced the corporate veil—except to note one unifying principle: the corporate form will be disregarded when not to do so would work an injustice upon innocent third parties. Here, innocent third parties dealt with each individual corporation in reliance upon, rather than in ignorance of, the distinctive corporate identity of each. Here, therefore, to disregard these distinctive corporate identities would work the very injustice the principle is intended to avoid. As this Court has noted:

> Courts are reluctant to pierce the corporate veil and destroy the important fiction under which so much of the business of the country is conducted, and will do so only under such compelling circumstances as requires such action to avoid protecting fraud, or defeating public or private rights.

Maule Industries v. *Gerstel,* 5 Cir. 1956, 232 F.2d 294, 297.

Another principle that is fundamental to the achievement of a just result in the present case is that no disbursement relied upon by the claimants in their submission of claims may be regarded as "legitimate" within the mandate of our

earlier opinion if it was made in contravention of state corporate law. In certain instances, state statutory law should afford a clear guide to the district court in making its determinations of legitimacy. Florida law governs USAFORM, New York law governs Limited, and Delaware law governs Pan-Am. State business corporation statutes typically proscribe certain distributions in the form of dividends or otherwise that have the effect of impairing the capital of the corporation. Florida law, Fla.Stat.Ann. § 608.52, permits payment of dividends to shareholders only from the net earnings of the corporation or from the surplus of assets over the liabilities. Fla.Stat.Ann. § 608.54 prohibits the directors from making any distribution to shareholders which would decrease the capital of the corporation, except as permitted under Fla.Stat.Ann. §§ 608.52, 608.16. No distribution of capital is permitted that would have the effect of reducing the assets of the corporation below the amount of its liabilities. Fla.Stat.Ann. § 608.18(6). Similarly, New York law prohibits any declaration of dividends or any distribution of assets to shareholders unless after such declaration or distribution the remaining assets are at least equal to the aggregate liabilities of the corporation. 58 McKinney's Consolidated Laws of New York, Stock Corporation Law, § 58. The Delaware Business Corporation Law, § 170, permits the payment of dividends only out of surplus as defined by §§ 154, 242, 243, and 244 of the statute, or out of the net profits for the fiscal year in which the dividends are declared.

[6] The district court in its earlier opinion found that "the named insureds were *all insolvent at all times* when the . . . illegal transfers were being made . . . ." 318 F.Supp. at 1308 (emphasis added). Because the only issue on remand from our 1972 decision was whether the

wrongfully appropriated funds were used to pay legitimate corporation obligations, this finding—indeed, all findings and conclusions of the district court in its first opinion not germane to the issue on remand—were binding upon the district court. *See, e.g., Gulf Coast Building & Supply Co., Inc.* v. *International Brotherhood of Electrical Workers, Local No. 480, AFL-CIO,* 5 Cir. 1972, 460 F.2d 105.

[7] State common law also affords standards by which the district court must judge the legitimacy of the disbursements that are the basis of the claims involved in this case. In this regard the following finding of fact made by the district court in its first opinion, 318 F.Supp. at 1310, is important:

> . . . except for Clarke, there were no real officers of these corporations as that term is understood. He was the Alpha and Omega of the named insured corporations. His employees who held various titles, and thus were officers in name only, exercised no authority but simply did Clarke's bidding. He set the policies, he issued the orders, he made the decisions. He would brook no disagreements. While his subordinates grumbled among themselves about his actions, there was no open revolt because it was apparent that it was either "vote aye or resign." He would squelch any dissent by reminding his "officers" that he was the boss — that these were his companies — and that he would decide how the money would be spent.

This finding is unaffected by the 1972 opinion of this Court. 463 F.2d 4.

In certain respects these facts found by the district court resemble those in *Geddes* v. *Anaconda Copper Mining Co.*, 1920, 254 U.S. 590, 41 S.Ct. 209, 65 L.Ed. 425. The district court in its second opinion erroneously held that *Anaconda* had no application because in the present case no stock-

holder had attacked any of the transactions involved, whereas in *Anaconda* minority shareholders had done so. In *Anaconda,* all of the assets of a certain company were sold to the Anaconda Copper Mining Company. All corporate formalities were properly observed. The Supreme Court noted that one individual at the time of the sale was the president and a director of the acquired company and also a director and general manager of Anaconda Copper. He "dominated the conduct of the practical administration of the affairs of [a third company involved in the case] and Anaconda . . . , and . . . he very certainly was in control of the boards of directors of the companies which were parties to the sale of [the assets of the acquired company]." 254 U.S. at 599, 41 S.Ct. at 212. The Court, in upholding the district court's finding that the consideration by the Anaconda Company to acquire the assets was inadequate, relied upon the following principles of law:

> The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness and where a sale is involved, the full adequacy of the consideration. Especially is this true where a common director is dominating in influence or in character. This Court has been consistently emphatic in the application of this rule, which, it has declared, is founded in soundest morality, and we now add, in the soundest business policy. [Citations omitted.]

254 U.S. at 599, 41 S.Ct. at 212.

Anaconda was, of course, decided before *Erie,* but it has been relied upon by many state supreme courts. We have found no Florida case adopting these principles just quoted

explicitly, but Fidelity has not countered the claimants' assertion that the *Anaconda* principles apply to the corporations involved in this case. The full implications of applying those principles to the present case may be further developed on remand.

Similarly, the district court erroneously held that *Pepper* v. *Litton,* 1939, 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281, had no applicability to the facts before it because *Pepper* "involved a scheme in fraud of creditors" whereas the present case involved, at that stage of the proceedings, only the question whether certain corporate disbursements were for legitimate corporate purposes. The principles relied upon by Mr. Justice Douglas in *Pepper* are vital and relevant. Mr. Justice Douglas noted the following "cardinal principles of equity jurisprudence":

> A director is a fiduciary. [Citation omitted.] So is a dominant or controlling stockholder or group of stockholders. [Citation omitted.] Their powers are powers in trust. [Citation omitted.] Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. [Citation omitted.] The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. [Footnote omitted.] If it does not, equity will set it aside. . . . [T]hat standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation . . . . [Footnote omitted.]

308 U.S. at 306-307, 60 S.Ct. at 245. Again, although Fidelity has not challenged the claimants' reliance upon *Pepper* as a fair statement of principles governing such transac-

tions under Florida, New York, or Delaware law, the full implications of the case may be developed on remand.

With these observations in mind, we now turn to an analysis of the validity of the district court's determinations regarding each of the specific claims presented to it upon remand. At the outset, we note that many of the claims advanced at the original trial were abandoned in the proceedings upon remand because, as counsel note in their brief, the claimants felt that it was impossible to demonstrate with respect to those claims an actual loss, as defined in our earlier opinion, to the particular corporation involved. We proceed to examine the district court's findings with respect to each claim renewed by the claimants on remand.[3]

CLAIMS ASSERTED BY USAFORM

1. Payment of 1961 pool debts of Inc. by USAFORM in the amount of $170,467.18.

[8, 9] The district court found that "by formal contract ratified and approved by [USAFORM's] board of directors . . . [USAFORM] assumed all liabilities and obligations of [Inc.], including the 1961 Hail Pool debts." The district court went on to hold that the debts, once *assumed* by USAFORM, were "legitimate". The court did not adequately address the question whether the assumption of the debts by USAFORM was proper. None of the parties contends that the debts paid by the funds transfered by USAFORM were not legitimate debts. They clearly were legitimate debts of *Inc.* The crucial question is whether USAFORM's assumption of the debts was legitimate.

[3] The opinion of the district court on remand after our 1972 opinion is not reported. As noted, the first opinion is reported at 318 F.Supp. 1301.

The "assets" of Inc. before the transfer here took place consisted of a debt owed the corporation by Clarke of $115,000, and other assets of $110,000, for a total of $225,000. The liabilities outweighed these "assets" by $50,000. They consisted primarily of debts due to creditors of the 1961-1962 Hail Pool Inc. which they had been managing, and they exceeded $275,000. After the transaction involved here, Inc. "retained" the $115,000 debt owed by Clarke. It transferred the assets of $110,000 and its liabilities, which had grown to $285,000, to the newly formed USAFORM, and it then became inactive. The claimants argued below, and argue here, that the net effect of this transfer was that funds held in trust were wrongfully appropriated to finance an opening deficit in USAFORM, and that Clarke's debt of $115,000 to Inc. was "washed out" by payments made to Inc.'s former creditors from funds now held by USAFORM. In other words, the balance sheet of Inc. after the transaction would show as an "asset" the $115,000 debt due from Clarke, and would show no liabilities owing to creditors on the liabilities side. USAFORM's balance sheet after the transaction would initially show assets of $110,000 and liabilities in excess of $285,000. In its first opinion, 318 F.Supp. 1301, the district court found that all the corporations involved here were insolvent at all relevant times. In light of that fact, and in light of his findings with respect to the dominant — even domineering — role played by Clarke and the clearly dishonest and fraudulent invasions of monies held in trust for others of which Clarke was guilty, we believe that the district court focused on the wrong question. In the third paragraph of its finding on this transaction, it notes that there was no evidence of a dishonest or fraudulent act in paying the 1961 pool debts that USAFORM had assumed. Apparently it did not scrutinize the contract by which the transaction

was consummated in the first place, other than to note that the contractual formalities had been observed. On remand, it must reconsider this assumption of assets and liabilities from the point of view of each corporation involved, and it must specifically determine whether each satisfied a legitimate corporate obligation in undertaking the transaction. The district court made no findings on the adequacy of the consideration for the assumption of the assets and liabilities, a question highly relevant to the legitimacy of the assumption itself. Finally, because this Court earlier affirmed the district court's findings with respect to fraudulent invasions of trust funds, we think it appropriate to impose upon the party seeking to rely upon the legitimacy of the transaction the burden of proving it, in accordance with *Anaconda* and *Pepper*.

2. Advance of $14,000 to Halifax Insurance Agency by USAFORM.

[10] The district court found that USAFORM, by a check drawn upon its general account, advanced $14,000 to Halifax Insurance Agency, and described the payment on its books as an "advance". The district court characterized Halifax as an "affiliated corporation", and noted that it had been a joint insured on the bond, and that it had produced "some business for other Clarke corporations". Clarke owned 50 percent of the stock of Halifax, but its business appears to be otherwise unrelated to USAFORM, whatever might be said of its relationship with still other "Clarke corporations" mentioned by the district court. The district court noted that the "advance" was "necessary to keep Halifax afloat". Nowhere, however, does the district court address the question whether it was a legitimate corporate obligation *of USAFORM* to keep Halifax afloat. The district judge relied also on the fact that Clarke had "discussed the situation with several of the directors". In light

of his findings, quoted above and affirmed in our 1972 opinion, regarding the dominant position of Clarke, that fact can have little weight in assessing the validity of the "advance".

The district court seems to have been impressed by the argument that "if one member of the corporate complex failed, it would cause the other members to fail, and that too, would ruin any chances of selling [USAFORM]". That may or may not be the case, but the effect on the corporate complex is irrelevant. The inquiry should have been whether this particular advance fulfilled a legitimate obligation owed by USAFORM to Halifax. Under *Anaconda* and *Pepper,* the burden of proving the legitimacy of this sort of intercorporate transfer is, in the circumstances of this case, on the party that relies upon that validity to escape liability on the bond, namely, Fidelity. The district court erroneously placed the burden upon the claimants. The court noted that there was no evidence to show that [USAFORM] was prohibited by either its by-laws or its charter from making the loan or advance to Halifax. This disregards completely the state statutory prohibitions against impairment of capital and against payments (however disguised) of dividends to shareholders unless the statutory preconditions are met, and it disregards the state common law regarding the heavy burden of proving the utmost fairness in transactions between a corporation and one of its directors or in transactions involving a director's corporation and inuring to his benefit. What happens to other corporations in the "network" should be of no concern to the district court in approaching this question. Rather, the court should focus only upon USAFORM and whether it had a legal obligation to advance the $14,000.

3. USAFORM's advances to Limited in the amount of $63,331.10.

[11] The district court found that Limited's balance sheet as of December 31, 1962, reflected "advances" it had received from USAFORM in the amount of $63,331.10. The district court noted that "there were reciprocal advances between [USAFORM] and Limited in 1962. The practice of reciprocal advances between the affiliated corporations was a form of mutual assistance which was of long standing, and it was not wrong per se." First, this broad proposition is at odds with the principles embedded in the statutory and case law we have already discussed. The district court attempted to bolster its analysis by noting that all of the intercorporate transactions were plainly noted upon the books, and appeared in audits conducted by certified public accountants. The court said that "concealment is the badge of fraud. Any person who perpetrates a fraud on another does not make an open record of that fact." But lack of "concealment" does not automatically transform an "advance" that appears at best to be questionable into one made to meet a legal obligation of USAFORM. Moreover, here as elsewhere, the district court tended to confound the issue whether there had been fraud and dishonesty with the issue whether the wrongfully appropriated monies were applied to a legitimate corporate obligation. We repeat that the court's earlier findings of fraud and dishonesty were affirmed by this Court in its 1972 opinion and were not open to reconsideration on remand.

The district court further noted that there was no evidence that Clarke received any personal benefit from the advance to Limited. Whatever the legal significance of this finding, it appears to be clearly erroneous, because Clarke was the sole shareholder of Limited, Limited was insolvent,

and Limited received the $63,331.10. It is possible that this transaction (and others discussed here as well) might be characterized *both* as payments to corporations that had no legal claim to payment and as payments that redounded to the personal benefit of directors or officers.

[12] Another shortcoming of the district judge's analysis of this claim was his disregard of the insolvency of the corporations. As we have noted above, the insolvency of a corporation *may* make illegitimate disbursements that otherwise might be legitimate, depending upon state statutory and common law. Because Fidelity relies upon the propriety of Clarke's actions, the burden on remand is on Fidelity to demonstrate the propriety of the advances, since Clarke was, under *Anaconda* and *Pepper*, a fiduciary in a position fraught with possibilities of conflict of interest. On remand, then, the district court will determine whether USAFORM, an insolvent corporation, owed any legitimate obligation to Limited to make the advance of $63,331.10.

The transfer here was effected by an assignment to Limited by USAFORM of premium monies due to USAFORM. In this respect, the transaction is similar to that involved in *Duel* v. *National Surety Corp.*, E.D.Wis.1945, 64 F.Supp. 961. In the 1972 appeal of this case, we referred to the facts of *Duel* as follows:

> The insured under the fidelity bond was an insurance company. Its general agent caused premiums due to be assigned to a corporation which was under his control. Thus the premium money went not to pay legitimate debts of the insured company, but into the pockets of the double-dealing employee.

463 F.2d at 7. The district court should give due regard to *Duel* in considering this claim upon remand.

Finally, we should note that we do not understand the meaning of the phrase "reciprocal advances between [USAFORM] and Limited" as used in paragraph 2 of this district court's finding on this claim. Our confusion is not diminished by the district court's later reference to "reciprocal advances" as "clearly debit and credit transactions between the insured". Neither term has any *a priori* legal significance, and, if the district court pursues this line of analysis again upon remand, it should state its findings of fact more fully.

4. Payment by USAFORM of debenture to Clarke in the amount of $10,000.

The district court found that USAFORM was organized in 1961 with $100,000 worth of capital consisting of 400 shares of common stock, all of which Clarke owned, and that Clarke paid into the corporation $100,000 which he had borrowed from a bank, pledging the stock as security. USAFORM also issued debentures with a face value of $100,000 which were sold at a discount to Clarke for $94,200, which amount he borrowed from two banks, pledging the debentures as security for the loan. In July 1962, USAFORM issued a check in the amount of $10,000 to Clarke to pay one of the $10,000 debentures which had become due according to its terms. On the same date, the district court found, Clarke paid one of the banks holding the pledged debentures $10,000 drawn on his own account to redeem the debenture in question, and then returned it to USAFORM. USAFORM carried this debenture on its books as an "asset". The district court noted that the debenture was a legitimate corporate obligation. Its decision on this claim, however, was apparently influenced by the language in the 1972 opinion relating to insolvency, for it noted that "[USAFORM] could not recover on the bond for the $10,000 payment if it were solvent". On remand, the district court should consider whether USAFORM, as an insolvent corporation, could, under the state business corporation law regarding redemption of securities and debentures and reductions in capital, lawfully have redeemed the debenture.

5. Two payments by USAFORM to Clarke amounting to $2,450.

The district court noted that the parties stipulated that two checks totalling $2,450 were issued personally to Clarke, and were charged on USAFORM's books to "travel and entertainment expense". The district court noted that Clarke himself testified without contradiction that "he did a great deal of travelling in quest of business". The court then noted in rather abstract terms that generally speaking "travel and entertainment expense, incurred in quest of business, is a legitimate corporate business expense". Because, however, the rest of the findings seem to have been influenced by an erroneous view of the mandate of our 1972 opinion, we feel the better part of justice is to vacate this portion of the judgment as well, and remand for a more specific finding that these disbursements made by USAFORM were in payment of legitimate corporate obligations incurred on account of travel and entertainment undertaken for the benefit of USAFORM, and not for some other corporation in the Clarke empire.

CLAIMS ASSERTED BY LIMITED

1. Limited's advances to Pan-Am in the amount of $237,361.44.

The district court noted that Limited's balance sheet as of December 31, 1962, showed as an asset the $237,361.44 owed to it by its insolvent subsidiary Pan-Am. The court further observed that a certified public accountant, in

auditing the books after the collapse, "listed payments by Limited to Pan-Am over a three-year period, aggregating an amount in excess of the amount claimed, which would indicate that there were reciprocal debits and credits between Limited and Pan-American, with the net account receivable being shown on the balance sheet, which Limited carried as an asset." As we noted earlier in our discussion of the claim based on USAFORM's advances to Limited in the amount of $63,331.10, "reciprocal debits and credits" is a phrase that, without more, has no legal significance, and in fact does little to clarify what actually happened even as a matter of bookkeeping. If on remand the district court again pursues this line of analysis, it should make findings of fact that are more explicit on this point.

[13, 14] Proceeding in its analysis, the district court found that Limited purchased all the stock of Pan-Am's predecessor in name in 1959, so that Pan-Am became a wholly owned subsidiary of Limited, and that Pan-Am engaged in the same reinsurance brokerage business as Limited, except that Pan-Am operated in South America. The evidence disclosed that "in 1960, 1961, and 1962, Limited drew checks on its premium account . . . to the order of Pan-American . . . ." The district court said that this, without more, was insufficient to show fraud. Again, the district court confounded the fraud issue with the issue whether the particular insured corporation made a disbursement to satisfy a legitimate obligation it owed to a third party. The district court already found, and this Court approved its findings in its 1972 opinion, that the funds used in these transactions were fraudulently and dishonestly diverted from their proper accounts. The only issue remaining is whether the obligation to which the wrongfully appropriated money was applied was legitimate. Moreover, the district court again referred to the question of insolvency as if it were irrelevant to the question of the legitimacy of the obligation paid by Limited here. The court also appears to have lumped parent and subsidiary together for purposes of determining the legitimacy of the payments, for it noted "that the advances to Pan-American went to pay the overhead and operating expenses chargeable to Pan-American for bookkeeping purposes." The court was also impressed by the fact that the books of Limited showed accounts receivable from Pan-Am and that Pan-Am's books showed accounts receivable payable to Limited. Its observations on this score suggest that it did not regard Pan-Am and Limited as separate and distinct corporate entities, but, on the contrary, pierced the corporate veil — not to prevent injustice to innocent third parties, but rather to effectuate it. Here, again, the district court placed the burden on the claimants to prove "fraud and dishonesty". The real question was the legitimacy of the obligations covered by the disbursements, and, under *Anaconda* and *Pepper,* in the circumstances of the present case the burden of showing that legitimacy is upon Fidelity because Fidelity relies upon that legitimacy to protect it from recovery on the bond it wrote.

The claimants argue that before the acquisition of Pan-Am by Limited, Pan-Am had no assets and it had liabilities of approximately $1,000,000. Limited, on the other hand, had assets of $237,000, and an equal amount of liabilities due to underwriters. After the acquisition and the transfers in question Pan-Am had the same amount of liabilities except that it had paid its old creditors the $237,000 advanced to it by Limited, and therefore owed the $237,000 to its parent corporation, rather than to its former creditors (who, one might suppose, would be considerably more zealous in pursuing their debtor than Limited). The claimants contend that New York law prohibited the advance of the

$237,000 cash from Limited to Pan-Am. Nowhere does the district court address this contention, perhaps because of its erroneous view that insolvency was irrelevant to the legitimacy of a corporate disbursement. On remand, it must address the question whether, under New York law, Limited had a legitimate obligation to advance the $237,361.44 to Pan-Am.

2. Account receivable due from Clarke in the amount of $33,163.52.

The district court found that, according to Limited's balance sheet of December 31, 1962, Clarke owed the corporation $33,163,52. The court said: "On its face, the account receivable is a debit and credit transaction between Clarke and Limited. There is no coverage under the bond for debit and credit transactions." We have noted before that the characterization of a transaction as "debit and credit" is not helpful, without more, in determining the legitimacy of a particular disbursement. Our earlier observations apply with equal force to this finding of the district court. The court discussed in some detail the debts Clarke owed to the various corporations. With respect to a cumulative Clarke debt of $150,000, the court noted that "Clarke testified that the purpose of the loans was to pay income taxes. Stebler [an officer of Limited] testified that the account receivable on Limited's books represented advances to Clarke over a period of time." Nowhere, however, does the district court discuss what legitimate corporate obligation was owed to Clarke that would explain the entry on Limited books of a debt owed by Clarke in the amount of $33,163.52. The court summarizes some of the testimony of some of the officers to the effect that they were unaware that Clarke was committing any acts of impropriety against the corporations, but this testimony is only relevant to the knowledge and notice issues in the case, already decided against Fidelity,

318 F.Supp. at 1310, and affirmed in our 1972 opinion. Its discussion erroneously shifts in focus from the *specific* debt to Limited involved here to Clarke's *overall* indebtedness to *all* of the corporations he controlled. The court also erroneously relied on the absence of proof of "fraud and dishonesty" with respect to the specific claim in issue here, and it made the same apparent assumption regarding insolvency we have criticized in our treatment of other claims. The burden here, as in the case of the other claims we have discussed, is on Fidelity to demonstrate the legitimacy of the "loan" to Clarke. On remand the district court should focus upon what legal obligation Limited owed to Clarke that would account for the $33,163.52 entry on its books.

3. Loan receivable on Limited's books in the amount of $10,145.90.

[15] The district court found that a loan in the amount of $10,145.90 was carried on Limited's books. It noted, however, that "there is no evidence to show when or how the loan originated, to whom it was made, or that it was made to an employee of Limited. In any event, it was carried on Limited's books as an asset, which is the opposite of a loss." We attach no significance to this last observation of the district court, for any amount of money owed to a corporation by any party will be carried on its books as an asset. Moreover, an illusory "asset" is not necessarily the "opposite of a loss".

The district court held with respect to this claim: "There is no evidence to show any factual basis for the bald, conclusory assertion that the loan receivable is a fraudulent diversion of Limited's funds to the personal use of an employee." On the contrary, it appears that there *was* evidence regarding the nature of the loan and the identity of the borrower. As claimants note in their brief, "in addi-

tion to appearing as a 'loan receivable' on the December 31, 1962 balance sheet of Limited, this identical amount also appears on the December 31, 1962 balance sheet prepared by Norman Reitman as due from an employee, H. A. Stebler. The account prepared by Norman Reitman listed this loan under 'due from stockholder, H. A. Stebler', because Stebler had formerly been a stockholder of that corporation." We therefore cannot agree with the district court's finding that there was "no evidence" that the payment did not satisfy a legitimate corporate obligation. Furthermore, the district court, in the third paragraph of its findings with respect to this claim, again appears to have been influenced by a misapprehension of the import of our language regarding insolvency in the 1972 opinion. We must therefore vacate this portion of the judgment. On remand, the district court must address the question whether the loan was made to fulfill a legitimate corporate obligation owed by Limited to Stebler.

4. Limited's advance to International in the amount of $1,333.84.

[16] The district court found that Limited drew a check on its premium account payable to USAFORM International, Ltd., in the amount of $1,338.84. Here, again, the district court denied recovery on the bond because "fraud and dishonesty" had not been proved with respect to this payment. The court also indicated that the insolvency of Limited was irrelevant. Because we think it misapprehended the mandate both on the issue of fraud and on the question of insolvency, we must vacate this portion of the judgment and remand for specific findings on the question whether this disbursement by Limited went to satisfy a legitimate obligation it owed to International. We do not agree that there is "no evidence in the record" to show that the check was not in payment of a legitimate account owed

to International. As the claimants note in their brief, there *was* evidence — "the unrefuted testimony of Stebler . . . that International was a dormant corporation which in its entire existence had only earned a few hundred dollars." This evidence makes the transaction appear at least questionable, and the district court should pursue the question further on remand.

CLAIMS ASSERTED BY PAN-AM

1. Pan-Am's advances to Clarke and Stebler in the amount of $11,600.

The district court found that there were 21 checks drawn by Pan-Am on its premium account and made payable to Clarke and Stebler, amounting in the aggregate to $11,600. The district court reasoned:

> There is no evidence whatever to show the purpose of the payments. The payments are not charged on Pan-American's records to Clarke and Stebler personally. In light of the meticulous entries of all advances kept by the three corporations [claimants], the absence of any charges of the payments to Clarke and Stebler strongly indicates that the payments were for legitimate purposes.

The district court compounded the confusion by noting that "the uncontradicted evidence further shows that the payments now complained of are included in Limited's advances to Pan-American to enable Pan-American to pay its share of the overhead and operating expenses." We have already discussed the district court's findings relating to these advances by Limited to Pan-Am, and have determined that that claim must be reconsidered on remand. The fact that the checks involved in *this* claim were drawn on those funds advanced by Limited can give no support to the result the district court reached on this claim. On

remand, the district court must determine whether these payments to Clarke and Stebler were in satisfaction of legitimate corporate obligations owed to the two men, bearing in mind their special status as officers and directors, and, in the case of Clarke, controlling shareholder. Here, again, since Fidelity relies upon the legitimacy of the payments to protect it from recovery, it has the burden of demonstrating that legitimacy.

2. Pan-Am's advances to International in the amount of $16,800.

The district court found that 11 checks totalling $16,800 were drawn by Pan-Am on its premium account and made payable to International. Once again, the district court seems to have relied on the fact that these advances to International came out of monies already legitimately advanced to Pan-Am by Limited, in itself a question that must be reconsidered on remand. Thus, the court said, "Pan-American was no more than a mere conduit through which Limited paid International's overhead and operating expenses." The district court obviously overlooked the question whether Pan-Am (or, for that matter, Limited) had any legal obligation to pay International's overhead and operating expenses in Zurich. Its judgment with respect to this claim must, therefore, also be vacated. On remand, the court should make findings regarding the legitimacy of the obligations to International the payments made by Pan-Am were intended to satisfy.

* * * * * *

The district court has acted conscientiously and has taken great pains throughout the course of this litigation. Our examination of the record leads us to conclude, however, that the court misapprehended the mandate of the 1972

opinion of this Court. Regretfully, we vacate the judgment of the district court, and remand the cause for still further proceedings in conformity with the views here expressed.

Vacated and remanded.

APPENDIX B

IN THE
UNITED STATES DISTRICT COURT FOR
THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,
a Maryland corporation,

Plaintiff,

v.

USAFORM HAIL POOL, INC.,
a Florida corporation.
U. S. & FOREIGN MANAGEMENT, LTD.,
a New York corporation.
U. S. & FOREIGN MANAGEMENT, INC.,
a Florida corporation;
BARBARA B. MURPHY,
as receiver for each of said corporations,

Defendants.

(Stamped: "Filed Jan. 14, 1974 — Jacksonville, Fla.)

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This action arose out of the financial collapse of a small corporate empire, controlled by F. Wylly Clarke (Clarke), consisting of five corporations, engaged in related businesses of reinsurance brokers, managers of hail insurance pools, and a general insurance agency, in which, with one exception, Clarke owned all of the stock, and in the exception, he owned 50% of the stock.

Background

On August 30, 1963, Fidelity and Deposit Company of Maryland (F & D) brought this action for declaratory judgment against Usaform Hail Pool, Inc. (Hail Pool), U. S. & Foreign Management, Ltd. (Limited), U. S. & Foreign Management, Inc. (Management, Inc.), and Barbara B. Murphy, as receiver for the three corporate defendants, seeking a judicial determination of the rights and obligations of the parties to a blanket position bond (Clt's Ex. 1, App. pp. 239a-245a), (bond), wherein F & D was named as Underwriter, and Limited, Management, Inc., Hail Pool, Usaform Pan American, Ltd. (Pan American), and Halifax Insurance Agency, Inc. (Halifax), and two other Clarke corporations (not important here), were named as Insured.

After the action was brought, various insurance companies who were shareholders in the hail insurance pool, managed by Hail Pool (pool participants), and who had employed Limited and Pan American as insurance brokers (underwriters group), who were not named as insureds in the bond, made claims on the bond for the loss of their premium moneys allegedly held by Hail Pool, Limited, and Pan American, and sought to intervene in the action as parties defendant in order to assert their claims directly against F & D.

To avoid a multiplicity of suits, and upon a stipulation of the parties, an order was entered on October 3, 1964, which allowed Empire Insurance Company to intervene as the class representative for the pool participants, and Stuyvesant Insurance Company to intervene as the class representative for the underwriters group. The intervenors were ordered to plead to the complaint for declaratory judgment.

All defendants and intervening defendants filed an amended answer, and counterclaims consisting of twelve separate counts.

On motion by F & D, the court, on November 14, 1966, entered summary judgment dismissing Counterclaim Counts I, III, IV, V, VII, IX, X, XI, and XII, on the ground that there was no genuine issue as to any material fact, and that F & D was entitled to judgment as a matter of law on each of those counterclaim counts.

The court held that neither the pool participants nor the underwriters group had any right of action against F & D on the bond.

On appeal to the Court of Appeals for the Fifth Circuit, that court affirmed the judgment of the district court, and remanded the case for trial on the issues presented by Counterclaim Counts II, VI and VIII. *American Empire Insurance Company of South Dakota, et al.* v. *Fidelity and Deposit Company of Maryland,* 408 F.2d 72 (5th Cir. 1969), certiorari denied, 396 U.S. 818, 24 L.Ed. 2d 69. The intervening defendants representing the pool participants and underwriters group, except Pan American, are no longer before the Court.

On August 3, 1970, this case went to trial before the Court, without a jury, on the issues presented by Counterclaim Counts II, VI, and VIII. The issues presented by those counts were whether Hail Pool, Limited, and Pan American could recover on the bond, which insured the fidelity of their employees, the amounts which the Insured owed to the pool participants and underwriters group for premium moneys which the Insured had used to pay their operating expenses and other corporate obligations.

The trial proceeded on the legal theory that the bond covered the premium moneys belonging to the pool participants and underwriters group, and that, when the employees of Hail Pool, Limited and Pan American used those premium moneys, alleged to be "trust funds", to pay operating expenses and other corporate obligations of the Insured, they fraudulently embezzled or diverted those premium moneys belonging to the pool participants and underwriters group. Judgment was entered against F & D and in favor of the Insureds for the debts they owed to the pool participants and underwriters group. *Fidelity and Deposit Company of Maryland* v. *Usaform Hail Pool, Inc., et al.*, 318 F. Supp. 1301 (1970).

F & D appealed from that judgment to the Court of Appeals for the Fifth Circuit, and that court vacated the judgment, and remanded the case to this Court for further consideration and the entry of additional findings on the question whether the moneys taken from the insured companies' premium accounts went to pay legitimate expenses of the respective companies. *Fidelity and Deposit Company of Maryland* v. *Usaform Hail Pool, Inc., et al.*, 463 F. 2d 4 (5th Cir. 1972).

This cause came on for hearing on January 26, 1973, on the written list of claims presented by claimants which they contend represent losses for which they are entitled to recover in light of the legal principles established by the opinion of the Court of Appeals, and on F & D's written response to each of those claims.

The Court having heard the parties, and considered the evidence before the Court in light of the legal principles announced in the opinion of the Court of Appeals, finds the facts and states the conclusions of law, as follows:

Findings of Facts

I

Claims Asserted By Hail Pool

A. Payment Of Debenture To Clarke In Amount Of $10,000.00. The receiver for Hail Pool claims that the payment of $10,000 to Clarke to redeem a $10,000 debenture is a transfer of funds to him as stockholder, but the evidence in the record shows the fact to be otherwise.

1. Hail Pool was organized on November 18, 1961, with $100,000 capital, consisting of 400 shares of common stock, at $250 per share, all of which were issued to Clarke, and Clarke paid into the corporation $100,000 in cash, which he borrowed from Marine Midland Trust Company of New York, and pledged the stock as security.

2. At the same time, Hail Pool issued debentures, having an aggregate face value of $100,000, which the board of directors authorized to be sold on a discount basis; all of which were purchased by Clarke, and he paid into the corporation a total of $94,200 cash, which he also borrowed from Marine Midland Trust Company and Mercantile National Bank of Miami Beach, and pledged the debentures as security. Thus, the corporation received in its corporate bank account the full purchase price of both the stock and the debentures.

3. On July 10, 1962, Hail Pool drew its check to Clarke for $10,000, in payment of a $10,000 debenture which had become due. On the same date, Clarke drew his own check to the order of Marine Midland Trust Company for $10,000 to apply on the $100,000 loan, and to redeem the debenture, which he returned to the corporation, and the corporation carried it in its balance sheet as an asset.

4. The evidence fails to show that premium moneys were in fact used to redeem the debenture. The debenture was a legitimate obligation of the corporation, and the money was used to pay a legitimate obligation. Clarke was only a conduit through which the payment was made to Marine Midland Trust Company. Hail Pool could not recover on the bond for the $10,000 payment if it were solvent, and had adequate funds to pay all of its debts. The claimants have failed to meet the burden of proof required to prove that this item represents a loss covered by the bond.

B. Two Payments To Clarke Amounting to $2,450.00. The receiver for Hail Pool claims that two checks drawn to the order of Clarke for $1,200 and $1,250, respectively were moneys diverted to the personal use of Stockholder Clarke, and, therefore, represent a recoverable loss.

1. The mere assertion that the payments to Clarke are fraudulent diversions of funds, without more does not make out an insured loss. The parties have stipulated that the two checks were charged on Hail Pool's books to travel and entertainment expense. The parties are bound by that stipulation.

2. Clarke testified positively, and without contradiction, that the two checks were for travel and entertainment expense. He testified that he did a great deal of traveling in quest of business, and that testimony was corroborated by Grundy and Stebler.

3. Travel and entertainment expense, incurred in quest of business, is a legitimate corporate business expense. There is no evidence that Hail Pool did not get the benefit of the two payments. Hail Pool has sustained no loss as a result of these two payments to Clarke, much less a dishonesty loss.

C. Loan to Halifax In The Amount of $14,000.00 The receiver of Hail Pool claims that the loan to Halifax was a fraudulent diversion of corporate funds to the personal use of Stockholder Clarke, which caused Hail Pool a loss covered by the bond.

1. The mere conclusory statement that the loan was a dishonest and fraudulent diversion of corporate funds, without more, does not suffice to make out an insured loss. Dishonesty and fraud are not presumed, but must be proved by evidence that is clear, cogent, and convincing.

2. The undisputed evidence in the record shows that, on June 11, 1962, Hail Pool drew a check on its general operating account to the order of Halifax for $14,000, and entered the payment in its records as an account receivable from Halifax, and described it as an advance.

3. Clarke was a 50% stockholder of Halifax, and a 100% stockholder of Hail Pool. Halifax had been an affiliated corporation in the Clarke corporate empire since about 1958, and it had been a joint insured in the bond since it became effective on June 30, 1959. It conducted a general insurance agency in Daytona Beach, Florida, and there is evidence in the record that it did produce some business for the other Clarke corporations.

4. Clarke testified positively, and without contradiction, that the purpose of the loan was "to keep Halifax afloat." It was necessary to keep Halifax afloat. Clarke discussed the situation with several of the directors before it was made, and they all thought it was a wise investment at the time. Clarke further testified, without contradiction, that he never received any advances, salary, or expenses from Halifax over the years.

5. Clarke was trying to sell Hail Pool as a going concern about that time for enough money to pay off the cred-

itors of all of the corporations. His testimony that it was necessary to keep Halifax afloat strongly indicates that he was also trying to sell Halifax, for he testified that the value of the agency as a going concern was two and a half times the annual commissions earned on the renewal of the business on the books. If Halifax failed, it would have no value. Similarly, if one member of the corporate complex failed, it would cause the other members to fail, and that, too, would ruin any chance of selling Hail Pool.

6. There is no claim, and no evidence to show, that Hail Pool was prohibited by either its by-laws or its charter from making the loan or advance to Halifax. There is no evidence in the record to show that the loan was not made in good faith, and in the regular course of business. The evidence shows that Hail Pool's stockholders, directors, and officers believed at the time that the loan was in the best interests of Hail Pool.

7. The situation here is very similar to the situation in *Kerr* v. *Aetna Casualty & Surety Co.*, 350 F.2d 146, 150 (4th Cir. 1965). In that case there were numerous transactions between several of the insured named in the bond, including loans, contributions to capital, advances and commissions. The court held that there was no loss with respect to those items. The court further held that positive acts of wrongdoing against the insured corporations must be shown for there to be a recovery on the fidelity bond (350 F.2d at p. 151).

8. Certainly the loan to Halifax is not a dishonest and fraudulent diversion of funds per se. The receiver has not met the burden of proof necessary to establish the loan as a dishonesty loss for which there can be a recovery on the bond. On the evidence in the record, Hail Pool could not recover this item as an insured loss, if it were solvent, and

had sufficient assets to pay its debts, and the receiver, whose rights are no better, cannot recover.

D. Hail Pool's Advances of $63,331.10 To Limited. The receiver for Hail Pool claims that Hail Pool's advances to Limited are fraudulent diversions of corporate funds to other corporations without legal claims, and, therefore, they constitute an insured loss.

1. Limited's balance sheet at December 31, 1962 showed advances payable to Hail Pool in the amount of $63,331.10, and that appears to be the basis of the receiver's claim for $63,331.10. The ground upon which the receiver claims that those net advances to Limited are fraudulent diversions of Hail Pool funds is that Limited is a corporation solely owned by Clarke. The fact is that Hail Pool, too, is solely owned by Clarke. That fact alone does not make the advances fraudulent.

2. The clear and undisputed evidence shows that there were reciprocal advances between Hail Pool and Limited in 1962. The practice of reciprocal advances between the affiliated corporations as a form of mutual assistance which was of long standing, and it was not wrong per se. These reciprocal advances are clearly debit and credit transactions between the insured. Everything appears on its face to be open, and above board. The certified public accountants who audited the books were unanimous in their testimony on that point. That is the very opposite to dishonest and fraudulent diversions. Concealment is the badge of fraud. Any person who perpetrates a fraud on another does not make an open record of that fact.

3. There is no evidence that any employee of Hail Pool, including Clarke, received any personal benefit from the advances. The transactions were not dishonest or fraudulent per se. If both Hail Pool and Limited were solvent and

able to pay their debts in full, the advances would be considered legitimate business transactions between the insured, and Hail Pool could not recover the balance from F & D as a dishonesty loss. The burden is on the receiver to prove positive acts of wrongdoing against the insured corporations and a resulting loss before there can be a recovery, and that burden has not been met here. It is important to keep in mind that the bond insured only the several insured against losses due to acts of dishonesty against the insured, and not the insured's creditors.

E. Payment Of 1961 Pool Debts In Amount of $170,467.18. The receiver for Hail Pool Claims that the payment of the 1961 Hail Pool debts out of the 1962 premium moneys is a dishonest diversion of Hail Pool funds to other corporations without legal claim to the funds, and that it is an insured loss.

1. The receiver has adduced no factual evidence to support this claim. There is no factual basis for the claim. On the contrary, the evidence shows clearly that there is no basis for the claim in fact or law under the legal principles which govern this case.

2. By formal contract ratified and approved by Hail Pool's board of directors on November 30, 1961, Hail Pool assumed all liabilities and obligations of Management, Inc., including the 1961 hail pool debts. The 1961 hail pool debts were valid contract obligations of Hail Pool to the same extent as the debt for office rent would be. "(T)he taking of money from the premium account of an insured company to pay other legitimate obligations of that company does not constitute a loss within the meaning of the fidelity bond before us in this case" (463 F.2d at p. 7).

3. There is no evidence to support a charge that any employee of Hail Pool committed a dishonest or fraudulent act in paying the 1961 pool debts. There is no evidence to prove that Hail Pool sustained a loss through such payments. If Hail Pool were a going concern, and financially able to pay its debts, it could not recover on the bond on account of such payments.

4. Positive acts of wrongdoing against Hail Pool must be shown with respect to each of the claimed losses before there can be a recovery on the bond. The Court finds that no such acts have been shown and that all of the claimed losses to Hail Pool were not caused by any fraud or dishonesty of its employees covered by the bond.

II

Claims Asserted By Limited

A. Limited's Advances To Pan American $237,361.44. The receiver for Limited claims that the advances to Pan American were fraudulent diversions of Limited's funds to Pan American, which make out an insured loss.

1. The receiver asserts a claim for the entire amount shown on Limited's Balance Sheet as of December 31, 1962, which was prepared by Stebler. Greenfield, a certified public accountant, employed by the underwriters group, listed payments by Limited to Pan American over a three year period, aggregating an amount in excess of the amount claimed, which would indicate that there were reciprocal debits and credits between Limited and Pan American, with the net account receivable being shown on the balance sheet, which Limited carried as an asset.

2. In 1959, Limited purchased all of the stock of Pan American's predecessor in name. Thus, Pan American became a wholly owned subsidiary of Limited to engage in the same reinsurance brokerage business as Limited, but

Pan American would operate in South America. Pan American and Limited occupied the same offices; they shared the overhead and operating expenses; they had identical boards of directors; and their two top officers were the same. Pan American has been a joint insured in the bond since its acquisition by Limited. Saul Greenfield, a certified public accountant employed by the underwriters group, considered that Limited and Pan American had identical interests, and that they were one and the same corporations for all practical purposes. He prepared a combined balance sheet for both corporations as of February 28, 1963.

3. The receiver's evidence adduced at the trial of the case, for the purpose of proving the allegations in Limited's Counterclaim Count VI that "Clarke, acting alone and/or in collusion with other employees of Limited, did fraudulently and/or dishonestly embezzle, steal, (or) divert *** reinsurance premiums *** belonging to the underwriters group," shows only that, in 1960, 1961, and 1962, Limited drew checks on its premium account in Marine Midland Trust Company to the order of Pan American, and nothing more. That evidence is totally insufficient to support the present claim that Limited's employees embezzled, stole, or diverted Limited's moneys from Limited which caused Limited a loss within the meaning of the bond.

4. The evidence shows, without dispute, that the advances to Pan American went to pay the overhead and operating expenses chargeable to Pan American for bookkeeping purposes. The payments must be considered in the same light as if Limited had paid all of the overhead and operating expenses of both corporations by check, and charged Pan American with its pro rata share of those expenses by means of debit and credit memorandums. The better bookkeeping practice is to use checks instead of internal debit and credit memorandums. In either event, the books of Limited would show accounts receivable from Pan American, and Pan American's books would show accounts payable to Limited, and that is exactly what the books of both corporations did show.

5. There is no evidence that any employees personally benefitted from the advances. There is no evidence to show that the advances were motivated by fraud or dishonesty on the part of Limited's employees. Fraud and dishonesty are never presumed. The burden is on him who charges fraud and dishonesty to prove them by evidence that is clear and convincing.

6. The claim here that Limited's advances to Pan American caused Limited a loss due to the fraud and dishonesty of Limited's employees is identical with the claim of the trustee for National Discount in *Kerr* v. *Aetna Casualty & Surety Co.*, 350 F. 2d 146, 150, 151 (4th Cir. 1965). There, National Discount made advances and loans to Title, its wholly owned subsidiary to enable the latter to stay alive, and operate. The trustee there made the same argument which is made here, but the court held that the claimed losses to National Discount were not due to any fraud or dishonesty covered by the bond. The court held "that positive acts of wrongdoing against the insured corporation must be shown" in order to establish an insured loss.

7. The Court finds that Limited's advances to Pan American were not fraudulent or dishonest diversions of its funds by its employees which caused it a loss covered by the bond. The Court further finds that, if Limited were now solvent, and had sufficient assets to pay its debts in full, it could not recover those advances as losses under the bond, and the receiver, whose rights are no better than Limited's cannot recover.

B. **Account Receivable Due From Stockholder $33,163.52.** The receiver for Limited now claims that the account receivable from Clarke shown on Limited's Balance Sheet as of December 31, 1962, is a fraudulent diversion of Limited's funds to the personal use of Clarke, which caused Limited a loss due to Clarke's fraud and dishonesty covered by the bond.

1. The balance sheet was prepared by Stebler, Limited's vice president and treasurer, and it lists as an asset, "Due from stockholder $33,163.52." On its face, the account receivable is a debit and credit transaction between Clarke and Limited. There is no coverage under the bond for debit and credit transactions.

2. The bond covers only losses caused by the fraudulent or dishonest acts of the Insured's employees. Clarke testified by deposition, without contradiction, that he owed Management, Inc. and Limited approximately $150,000 on account of loans obtained from them over a period of time from about 1954 to the end of 1961, and that the $150,000 figure represented the cumulative amount of the several loans. Clarke testified that the purpose of the loans was to pay income taxes. Stebler testified that the account receivable on Limited's books represented advances to Clarke over a period of time. Clarke also testified, without contradiction, that his salary for all three operating corporations was set at $37,500 per year, but he had never drawn the full salary, and in 1962, he testified that he and his wife together were paid only $30,000 as salary. Clarke further testified that, in 1962, he had incurred traveling expenses in behalf of the three corporations which amounted to between $25,000 and $30,000, which he personally paid out of his own pocket, and for which he had not been reimbursed.

3. Barbara Murphy, testifying in her own behalf, stated that she actually handled Clarke's personal bank account; that she deposited his checks in the bank account; that she drew checks on that account in payment of his household bills; that she reconciled his bank statements with the cancelled checks; and that, in handling Clarke's personal affairs, she saw no evidence that Clarke had committed any acts of impropriety against the corporations. She testified that Clarke "was going all over the country trying to sell the hail pool business; and he even applied to the Small Business Administration for loans to try to pay off all creditors." She testified in addition that Clarke took no money from the corporations improperly, and that he was not dipping into the tills. The conduct described by Clarke and by Murphy, which stands uncontradicted, does not equate with fraud or dishonesty.

4. No one has ever claimed, or even suggested, that the advances were not entirely legitimate transactions when made. Each advance was clearly recorded on Limited's records by someone other than Clarke, and they appeared on the books for all to see. The advances were not fraudulent per se. Fraud and dishonesty are never presumed. He who charges fraud or dishonesty must prove the charge by evidence that is clear and convincing. Positive acts of wrongdoing against Limited must be shown in order to make out an insured loss. The Court finds that there is no evidence to support this claimed loss to Limited which is due to any fraud or dishonesty covered by the bond. The Court further finds that, if Limited were now solvent, and had assets with which to pay its debts in full, it could not recover such advances under the bond, and the receiver, whose rights are no better than Limited's cannot recover.

C. Loan Receivable $10,145.90. The receiver for Limited claims that a loan receivable shown on Limited's Balance

Sheet as of December 31, 1962 in the amount of $10,145.90 is a fraudulent diversion of Limited's funds to the personal use of its employees which caused it a loss covered by the bond.

1. The only evidence of this loan receivable is Limited's Balance Sheet as of December 31, 1962, which was prepared by Stebler, Limited's vice president and treasurer. Although the receiver for Limited examined Stebler by deposition on the balance sheet at the trial, Stebler was not questioned about this loan receivable. The only evidence about it is that it appears on the balance sheet. There is no evidence to show when or how the loan originated, to whom it was made, or that it was made to an employee of Limited. In any event, it was carried on Limited's book as an asset, which is the opposite of a loss.

2. There is no evidence to show any factual basis for the bald, conclusory assertion that the loan receivable is a fraudulent diversion of Limited's funds to the personal use of an employee. There is no evidence to show that Limited was involuntarily deprived of the proceeds of the loan. On the record, it appears to be a legitimate and bona fide transaction.

3. The Court finds no evidence to show any positive acts of wrongdoing against Limited with respect to this claim, and that the claimed loss to Limited does not result from any act of fraud or dishonesty covered by the bond. If Limited were solvent, and had assets sufficient to pay its debts in full, it could not recover this item of claim under the bond, and the receiver, whose rights are no better than Limited's cannot recover.

D. Limited's Advances To International $1,333.84. The receiver for Limited now claims that a check drawn by Limited on the premium account in Marine Midland Trust

Company to the order of Usaform International, Ltd. for $1,333.84 is a fraudulent diversion of Limited's funds to International which caused Limited an insured loss.

1. The check appeared on a list of checks prepared by Saul Greenfield at the receiver's request to show Limtied's transfers of funds from the premium account to Limited's operating account, or to pay other obligations of Limited, on the theory that such transfers constituted embezzlement or theft by Limited of "trust funds" which made out an insured loss. That theory has been rejected by the Court of Appeals, and the check, standing alone, provides no evidence that it was a fraudulent or dishonest diversion of funds which caused Limited a loss within the meaning of the bond.

2. There is no evidence in the record to show that the check was not in payment of a perfectly legitimate account owed by Limited to International. Fraud and dishonesty cannot be presumed. The burden is on him who charges fraud and dishonesty to prove the charge by evidence that is clear and convincing. The Court finds that positive acts of wrongdoing against Limited have not been shown, and that this claimed loss to Limited does not result from any act of fraud or dishonesty which is covered by the bond. If Limited were solvent, and had assets with which to pay its debts in full, it would not be able to recover this item of claim as a loss under the bond, and the receiver whose rights are no better than Limited's cannot recover.

III

Claims Asserted by Pan American

A. Pan American's Advances To International $11,600.00. Pan American claims that eleven checks which were drawn on its premium account in Marine Midland

Trust Company, payable to International are fraudulent diversions of its funds to International, which caused it a loss covered by the bond.

1. The evidence in the record shows only that International was a European corporation formed for the purpose of handling the European and world wide reinsurance brokerage business for Limited and Pan American; that the corporation was organized by a trust company in Switzerland, which put up the money for the stock, and the trust company held the stock for the benefit of Limited; that the relationship between Limited and Pan American on the one hand, and International on the other hand, was that Limited and Pan American managed International; and that there were transfers from the premium account to International to cover the overhead of its office in Zurich, Switzerland.

2. The evidence further shows that the transfers complained of here are included in Limited's advances to Pan American to enable Pan American to pay International's operating expenses. Thus, Pan American was no more than a mere conduit through which Limited paid International's overhead and operating expenses. The evidence is clear that Pan American could have no loss on account of the advances to International, much less a fraud or dishonesty loss.

3. The Court fiinds no evidence to support this claimed loss to Pan American which was caused by any act of fraud or dishonesty covered by the bond.

B. Pan American's Advances To Clarke and Stebler $11,600.00. Claim is now made on behalf of Pan American that twenty-one checks drawn by Pan American on its premium account in Marine Midland Trust Company to the order of Clarke and Stebler during the year, 1962, amounting in the aggregate to $11,600 are fraudulent diversions of Pan American's funds to the personal use of Clarke and Stebler, which caused Pan American an insured loss.

1. There is no evidence in the record to support this claim. Fraudulent and dishonest diversions of funds cannot be presumed from the sole fact that the payments were made out of the premium account in Marine Midland Trust Company. There is no evidence whatever to show the purpose of the payments. The payments are not charged on Pan American's records to Clarke and Stebler personally. In light of the meticulous entries of all advances kept by the three corporations, the absence of any charges of the payments to Clarke and Stebler strongly indicates that the payments were for legitimate purposes. The uncontroverted testimony of Stebler is that he received nothing from either Limited or Pan American, except his salary.

2. The uncontradicted evidence further shows that the payments now complained of are included in Limited's advances to Pan American to enable Pan American to pay its share of the overhead and operating expenses. Pan American was no more than a conduit through which Limited made the payments for the overhead and operating expenses. Those payments are wash transactions, and the Court of Appeals has held that such transactions do not make out insured losses. *Fidelity and Deposit Company* v. *Usaform Hail Pool, Inc.*, 463 F. 2d 4, at p. 6; *Kerr* v. *Aetna Casualty & Surety Co.*, 350 F. 2d 146, 150 (4th Cir. 1965).

3. The Court finds that there is no evidence to support this claim that the payments to Clarke and Stebler caused a loss to Pan American due to any acts of fraud or dishonesty covered by the bond. The Court further finds that, if Pan American were now solvent, and had sufficient assets to pay its debts in full, it could not recover those payments

as a loss under the bond. Its insolvency does not improve its situation against the bonding company.

Conclusions of Law

Since jurisdiction is based on diversity of citizenship, 28 U.S.C.A., § 1332, the case is controlled by Florida law.

The bond in this case was written to indemnify the insureds against loss which the insureds shall sustain through any fraudulent or dishonest act of their employees, not losses sustained by the insureds' creditors. *Fidelity and Deposit Company of Maryland* v. *Usaform Hail Pool, Inc., et al*, 463 F. 2d 4, 5 (5th Cir. 1972); *Kerr* v. *Aetna Casualty & Surety Co.*, 350 F. 2d 146, 150 (4th Cir. 1965).

Fraud and dishonesty are never presumed and the burden of proving fraud and dishonesty is on the party who asserts it. *Biscayne Boulevard Properties, Inc.* v. *Graham, Fla.*, 65 So. 2d 858. Proof of fraud and dishonesty must be clear and convincing. *Middleton* v. *Plantation Homes, Inc., Fla.*, 71 So. 2d 503; *Biscayne Boulevard Properties, Inc.* v. *Graham, supra; Graessle* v. *Shultz*, 90 So. 2d 37, 38 (Fla. 1956).

In this case, the receiver for Hail Pool and Limited, and Pan American are the parties who have asserted that the claimed losses to each of them are caused by acts of fraud and dishonesty on the part of their employees in fraudulently diverting their funds to the personal use of employees, amounting to embezzlement or theft, or diverting their funds to others, which also amount to embezzlement or theft from the insured corporations. The burden is on Hail Pool, Limited, and Pan American to prove the acts of fraud or dishonesty by affirmative proof that is clear and convincing. The burden is not on F & D to prove that the claimed losses to each of the insured corporations was not caused by acts of fraud and dishonesty covered by the bond.

In order to show personal "fraudulent or dishonest acts" within the meaning of the bond, there must exist a compelling sense of conscious wrong rather than mere omission or act amounting to negligence. *Sade* v. *National Surety Corp.*, 203 F.Supp. 680, 684 (D.D.C. 1962), affirmed, 314 F.2d 286 (D.C. Cir. 1963).

In order to recover on the bond before us in this case, positive acts of wrongdoing against the insured corporations must be shown. *Kerr* v. *Aetna Casualty & Surety Co.*, 350 F.2d 146, 151 (4th Cir. 1965).

"The case must be viewed as if the insured companies were solvent and had adequate funds in their general accounts to replace the money diverted from the premium accounts. If the insureds cannot recover on the bond in that situation, their insolvency does not improve their case against the bonding company." *Fidelity and Deposit Company of Maryland* v. *Usaform Hail Pool, Inc., et al.*, 463 F.2d 4, 5 (5th Cir. 1972); *Scott* v. *Armstrong*, 146 U.S. 499, 507, 13 S. Ct. 148 (1892); *Fidelity & Casualty Co. of New York* v. *Hoyle*, 64 F.2d 413, 415 (4th Cir. 1933).

In order to recover on the bond in this case, it is necessary to prove first of all that the employees committed fraudulent and dishonest acts which caused the insureds a loss. Fraud and dishonesty are questions of fact which must be proved by evidence that is clear and convincing. They are not matters of law.

When the claims now asserted in behalf of Hail Pool, Limited, and Pan American are considered in light of the evidence in the record and the controlling principles of law, it is clear that the claimants cannot prove any affirmative acts of wrongdoing against the insured corporations. They cannot meet the standards which have been established to govern disposition of the case.

It is equally clear that bald, conclusory assertions of fraud and dishonesty, without more, will not establish fraud or dishonesty. The claimants have not pointed out any evidence in the record which will provide clear and convincing proof of the fraudulent or dishonest acts which they have asserted.

At the hearing on this case, the claimants cited several cases which they claimed supported their assertion of fraudulent and dishonest acts connected with each of the transactions now claimed to have resulted in a loss which is covered by the bond.

The first case relied on by the claimants is *Maule Industries* v. *Gerstel,* 232 F.2d 294 (5th Cir. 1956), which arose out of a bankruptcy proceeding, and it involved a petition by a creditor for a turnover order, requiring a corporation and its receiver to turn over the property of the corporation to the trustee of another bankrupt corporation. The petition alleged that the second corporation was controlled and directed by the first (bankrupt); that the second corporation had substantially the same officers, directors and stockholders, and that the second corporation was an instrumentality of the bankrupt corporation. The turnover order was denied, and the court said, (232 F.2d at 297):

> "The burden in this case is upon Maule (the petitioning creditor) to establish by pleadings and proof that Ludwig Bros., Inc. is 'an artifice and a sham designed to execute illegitimate purposes in abuse of the corporate fiction and the immunity that it carries'."

That case is not in point with the situation involved here, but on the question of fraud and dishonesty, the court reaffirmed the rule that the burden is on the party asserting fraud or dishonesty in any form to prove the charge by evidence that is clear and convincing.

Wooddale v. *Fidelity and Deposit Co.,* 378 F. 2d 627 (8th Cir. 1967), was an action on a fidelity bond, and the only question involved there was whether the culprit was an employee of the insured, or not. There, the piercing of the corporate veil doctrine was mentioned only indirectly. The court simply held that, in order to pierce the corporate veil, one must allege and prove that the corporation was organized for purposes of fraud. The only purpose in trying to pierce the corporate veil is to allow a creditor to go behind the corporation, and recover from the sole stockholder the amount of the corporate debt to the same extent as if the debt had been incurred by the stockholder as an individual. That has nothing to do with this case, for this is an action to recover on a fidelity bond for losses caused by the alleged fraudulent and dishonest acts of employees of the insured corporations.

Corsicana National Bank v. *Johnson,* 251 U.S. 68, 40 S. Ct. 82 (1919), was an action by a bank against its former director and vice president on a statutory cause of action which makes the directors liable to the bank for making illegal or excessive loans. That case is of no help whatever to the claimants in this case. This is not an action against the directors of the insured corporations, but an action to recover on a fidelity bond protecting the insured corporations against the acts of their employees.

Geddes, et al. v. *Anaconda Copper Mining Co.,* 254 U.S. 590, 41 S. Ct. 209 (1921), was an action by minority stockholders of a corporation to set aside a sale of the corporate assets to another corporation. The two corporations had a common director on both boards. That case has no application whatever to the situation involved here, for no stockholder has attacked any transactions complained of. Neither corporation has attacked any of the transactions

involved. That case is distinguishable from this case both on its facts and its law.

Finally, *Pepper* v. *Litton,* 308 U.S. 295, 60 S.Ct. 238, 84 L. Ed. 281 (1939), arose out of a bankruptcy proceeding, and involved the question whether the bankruptcy court could disallow either as a secured or as a general or unsecured claim a judgment obtained by the dominant and controlling stockholder of the bankrupt corporation on alleged salary claims. It involved a scheme in fraud of creditors, and the bankrupt trustee sought to set it aside. Again, that case has absolutely no applicability to anything involved in this action.

Here, no creditor has sought to set aside any transaction. No creditor has sought to pierce the corporate veil, and recover the alleged losses from Clarke as the sole stockholder. No creditor has attacked the validity of any transactions involved between the corporations.

This is an action on a fidelity bond to recover losses alleged to have been sustained through fraudulent or dishonest acts of the insureds' employees. The receiver for Hail Pool and Limited, and Pan American have not met the burden of proof required to show that their claimed losses are caused by acts of fraud and dishonesty covered by the bond.

On the evidence, considered in light of the legal principles which govern this case, the Court concludes that Barbara B. Murphy, as receiver for Usaform Hail Pool, Inc., Barbara B. Murphy, as receiver for U. S. & Foreign Management, Ltd., and Usaform Pan American, Ltd., are not entitled to recover anything against Fidelity and Deposit Company of Maryland under the bond. Accordingly, Counterclaim Counts II, VI and VIII are dismissed with prejudice.

Judgement will enter in favor of Fidelity and Deposit Company of Maryland dismissing the counterclaim counts.

DONE AND ORDERED at Jacksonville, Florida, this 14th day of January, 1974.

s/ CHARLES R. SCOTT
Judge

Copies to:

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Elmer W. Beasley, Esquire
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Thomas T. Cobb, Esquire
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IN THE
UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT COMPANY OF MARYLAND, a Maryland corporation,
Plaintiff,

v.

USAFORM HAIL POOL, INC., a Florida corporation; U.S. & FOREIGN MANAGEMENT, LTD., a New York corporation; U.S. & FOREIGN MANAGEMENT, INC., a Florida corporation; BARBARA B. MURPHY, as receiver for each of said corporations,
Defendants.

Stamped: "F I L E D Jan. 14, 1974 — Jacksonville, Fla."

FINAL JUDGMENT

This cause came on for final hearing before the Court and findings of fact and conclusions of law having been filed herein, it is, therefore,

ORDERED AND ADJUDGED:

That Barbara B. Murphy, as receiver for Usaform Hail Pool, Inc., Barbara B. Murphy, as receiver for U.S. & Foreign Management, Ltd., and Usaform Pan American, Ltd., do have and recover nothing; that Counts II, VI and VII of the counterclaim be dismissed on their merits, with prejudice; and that plaintiff Fidelity and Deposit Company of

Maryland do have and recover of and from defendants its costs to be hereinafter taxed by the Clerk.

DONE AND ORDERED at Jacksonville, Florida, this 14th day of January, 1974.

s/ CHARLES R. SCOTT,
Judge

IN THE
UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND, a Maryland corporation,
Plaintiff,

v.

USAFORM HAIL POOL, INC., a Florida corporation; U.S. & FOREIGN MANAGEMENT, LTD., a New York corporation; U.S. & FOREIGN MANAGEMENT, INC., a Florida corporation; BARBARA B. MURPHY, as receiver for each of said corporations,
Defendants.

Stamped: "F I L E D Jacksonville, Fla., Jan. 28, 1974
Wesley R. Thies, Clerk"

MOTION TO DISMISS APPEAL

Defendants move this Court to dismiss the appeal filed in this cause on November 19, 1973 under Rule 42(a) of the Federal Rules of Appellate Procedure for the reason that the judgment upon which said appeal was based has been vacated by this Court by Order dated January 14, 1974.

Defendants respectfully request that this Order be entered under Federal Rules of Appellate Procedure 27(b) without hearing and without awaiting a response hereto.

Cobb, Cole, Sigerson, McCoy,
Bell & Bond

By s/ W. WARREN COLE, JR.
Post Office Box 191
Daytona Beach,
Florida 32015
Attorneys for Defendants

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of this Motion has been served by mail to GEORGE STELLJES, JR., Esquire, Post Office Box 441, Jacksonville, Florida 32201 and ELMER W. BEASLEY, Esquire 880 Asylum Avenue, Hartford, Connecticut 06105, this 27th day of January, A.L. 1974.

s/ S. WARREN COLE, JR.
Attorney

IN THE
UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,
a Maryland corporation,

Plaintiff,

vs.

USAFORM HAIL POOL, INC., a Florida corporation; U.S. & FOREIGN MANAGEMENT, LTD., a New York corporation; U.S. & FOREIGN MANAGEMENT, INC., a Florida corporation; BARBARA B. MURPHY, as receiver for each of said corporations.

Defendants.

Stamped: "F I L E D Jacksonville, Fla., Jan. 28, 1974
Wesley R. Thies, Clerk"

ORDER

The Motion of Defendants to dismiss the pending appeal in this cause having been duly considered, it is hereby

ORDERED AND ADJUDGED:

1. That the appeal in this cause filed on November 19, 1973 is hereby dismissed, it appearing to the Court that said appeal has not been docketed in the Court of Appeals, and that the judgment upon which said appeal was based has been vacated by this Court.

2. That this Order is entered pursuant to Federal Rules of Appellate Procedure 27(b).

DONE AND ORDERED at Jacksonville, Florida, this 28th day of January, 1974.

s/ CHARLES R. SCOTT
Judge

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of this Order has been served by mail to W. WARREN COLE, JR., Esquire, Post Office Box 191, Daytona Beach, Florida 32015, GEORGE STELLJES, JR., Esquire, Post Office Box 447, Jacksonville, Florida 32201 and ELMER W. BEASLEY, Esquire, 880 Asylum Avenue, Hartford, Connecticut 06105, this 29th day of January, A.D. 1974.

WESLEY R. THIES, CLERK

By s/ FRANK HENDERSON, JR.
Deputy Clerk

IN THE
UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT COMPANY OF MARYLAND, a Maryland corporation,

Plaintiff,

vs.

USAFORM HAIL POOL, INC., a Florida corporation; U.S. & FOREIGN MANAGEMENT, LTD., a New York corporation; U.S. & FOREIGN MANAGEMENT, INC., a Florida corporation; BARBARA B. MURPHY, as receiver for each of said corporations,

Defendants.

NOTICE OF APPEAL

Notice is hereby given that Defendants, USAFORM HAIL POOL, INC., a Florida corporation; U.S. & FOREIGN MANAGEMENT, LTD., a New York corporation; U.S. & FOREIGN MANAGEMENT, INC., a Florida corporation; BARBARA B. MURPHY, as receiver for each of said corporations, hereby appeal to the United States Court of Appeals for the Fifth Circuit from the Final Judgment, and the Findings of Fact and Conclusions of

Law in support thereof, entered in this action on the 14th day of January, A.D. 1974.

Cobb, Cole, Sigerson, McCoy,
Bell & Bond

By s/ W. WARREN COLE, JR.
Post Office Box 191
Daytona Beach,
Florida 32015
Attorneys for Defendants

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing has been served by mail to GEORGE STELLJES, JR., Esquire, Post Office Box 447, Jacksonville, Florida 32201 and ELMER W. BEASLEY, Esquire, 880 Asylum Avenue, Hartford, Connecticut 06105, this 1st day of February, A.D. 1974.

s/ W. WARREN COLE, JR.
Attorney

APPENDIX C

IN THE
UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,

Plaintiff,

v.

USAFORM HAIL POOL, INC., a Florida corporation, U.S. & FOREIGN MANAGEMENT, LTD., a New York corporation, U.S. & FOREIGN MANAGEMENT, INC., a Florida corporation, BARBARA B. MURPHY, as receiver for each of said corporations.

Defendants.

Filed Jan. 14, 1974

ORDER

On August 2, 1973, this Court entered findings of fact, conclusions of law and a final judgment finally disposing of this case. Although the findings of fact and conclusions of law show on their face that copies were sent to counsel for all parties, it is a fact that neither plaintiff, defendants nor their respective counsel received notice of the entry of the final judgment until November 13, 1973. Upon learning that final judgment had been entered, defendants immediately filed a notice of appeal but the ordinary maximum time provided by Federal Rule of Appellate Procedure 4(a) for filing such notice had long since expired.

The same day they filed their notice of appeal defendants also filed a motion requesting (1) a new trial, (2) relief from judgment and (3) leave of court to file a belated notice of appeal. The Court will hereinafter deny the first and third motions but, in order to do justice, will grant the motion for relief from judgment and rescind the findings of fact, conclusions of law and final judgment, heretofore entered.

Rule 77(d) of the Federal Rules of Civil Procedure provides that "Immediately upon the entry of an order or judgment the clerk shall serve a notice of the entry by mail in the manner provided for in Rule 5 upon each party who is not in default for failure to appear, and shall make a note in the docket of the mailing". Nevertheless, no copy of the final judgment was received by any party or any counsel. Furthermore, in July 1973, counsel for defendants telephoned the Court to inquire if any ruling on the case had been made. Upon learning that it had not, he requested that the Court telephonically notify him when a ruling was made. The Court said that would be unnecessary because copies of the final judgment would be mailed by the Clerk's office as a matter of course.

Many unique circumstances justify the Court's action in granting the motion for relief from judgment in this case. For example: (1) the legal issues and factual background are complex, (2) nearly $1,000,000 is involved, (3) the cause has been in litigation for nearly 10 years, (4) the cause was under advisement for six months before the judgment was entered, (5) the failure of the Clerk or Court to notify litigants of the judgment, (6) the failure of all litigants to learn of the judgment during the allowable appeal time, and (7) the anticipation of an appeal by all litigants since the case has been before the Court of Appeals

on two previous occasions. *Wolfsohn* v. *Hankin,* 376 U.S. 203 (1964); *Thompson* v. *Immigration and Naturalization Service,* 375 U.S. 384 (1964); *Harris Truck Lines, Inc.* v. *Cherry Meat Packers, Inc.,* 371 U.S. 215 (1962); *Hill* v. *Hawes,* 320 U.S. 520 (1944).

It would be a sad commentary on our judicial system if strict adherence to the very formalities and rules established to insure justice were used to defeat justice.

> Throughout history men have had to suffer from legal systems which worshipped rigid formalities at the expense of justice . . . . Of course, any civilized system of judicial administration should have enough looseness in the joints to avert gross denials of a litigant's rights. . . I confess, however, that I am uncomfortable with the notion that courts exist to fashion and preserve rules inviolate instead of to apply those rules to do justice to litigants.

Berman v. *United States,* 378 U.S. 530, 537, (1964) (Black, J. dissenting).

In the instant cases equity and justice will best be served by vacating the earlier judgment and re-entering it today.

Rule 60(b) of the Federal Rules of Civil Procedure provides in pertinent part that:

> On motion and upon such terms as are just, the Court may relieve a party or his legal representative from a final judgment, order, or proceeding for the following reasons: . . . (6) any other reason justifying relief from the operation of the judgment.

The Court finds that in this case the "unique circumstances" enumerated above justify relief from the operation of the final judgment. Although this Court is precluded by the provisions of Rule 4 of the Federal Rules of Appellate

Procedure from granting defendants a belated appeal, Rule 60 of the Federal Rules of Civil Procedure provides the the Court with authority, under the unique circumstances presented herein, to grant the motion for relief from judgment. While a district court should be very reticent to use Rule 60(b) F.R.C.P. in order to circumvent the time requirements of Rule 4 F.R.A.P., the unique circumstances of this case certainly provide necessary cause to do so now.

No case cited by plaintiff in opposing the motion contains so many factors militating in favor of granting relief from judgment as appear in this case. *Cf. Gulf-Tampa Drydock Company* v. *Virginia Trader,* 435 F. 2d 150 (5th Cir. 1970); *Lord* v. *Helmandollar,* 348 F. 2d 780 (D.C. Cir. 1965); *Shotkin* v. *Weksler,* 254 F. 2d 596 (5th Cir. 1958).

Therefore, it is

ORDERED:

1. Defendants' motion for relief from judgment, filed herein November 19, 1973, is hereby granted.

2. Findings of fact and conclusions of law, entered herein August 2, 1973, and final judgment, entered herein August 2, 1973, are hereby rescinded, vacated and set aside.

DONE AND ORDERED at Jacksonville, Florida, this 14th day of January, 1974.

s/ CHARLES R. SCOTT,
Judge

Copies to:

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IN THE
UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,

Plaintiff,

vs.

USAFORM HAIL POOL, INC., a Florida corporation, U.S. & FOREIGN MANAGEMENT, LTD., a New York corporation, U.S. & FOREIGN MANAGEMENT, INC., a Florida corporation, BARBARA B. MURPHY, as receiver for each of said corporations.

Defendants.

Filed Nov. 19, 1973 Jacksonville, Fla.

The Defendants, USAFORM HAIL POOL, INC., U. S. & FOREIGN MANAGEMENT, LTD., U. S. & FOREIGN MANAGEMENT, INC., and BARBARA B. MURPHY, as receiver for each of said Defendants, move the Court for relief in one of the following alternatives:

1. A new trial under Federal Rules of Civil Procedure Rule 59(a) (2) on grounds that the final judgment entered in this cause contains substantial errors in the application of existing law to the facts of this case, and is contrary to the law of the case established in this cause in prior proceedings.

2. Relief from the judgment under Rule 60(b)(6) on the grounds stated in paragraph 1 hereof and on the grounds that in the manner hereafter stated the Defendants have been prejudiced by the actions of the Clerk and the Court in failing to inform defendants of entry of the judgment and it should, therefore, be vacated; or

3. Allowance of the filing of a Notice of Appeal instanter, there being unique circumstances in this cause justifying the Court's extension of time beyond the 30 day period contained in Federal Rule of Appellate Procedure 4(a). A Notice of Appeal is submitted herewith.

Defendants respectfully request the Court's consideration of the Memorandum in support of this Motion submitted herewith.

COBB, COLE, SIGERSON, MCCOY,
BELL & BOND

By W. WARREN COLE, JR.
444 North Beach Street
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Attorneys for Defendants

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of this Memorandum, along with the Notice of Appeal and Motion have been served by mail to GEORGE STELLJES, JR., Esquire, Post Office Box 447, Jacksonville, Florida, 32201 and ELMER W. BEASLEY, Esquire, 880 Asylum Avenue, Hartford, Connecticut, 06105, this 19th day of November A.D., 1973.

W. WARREN COLE
Attorney

IN THE
UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND

Plaintiff,

vs.

USAFORM HAIL POOL, INC., a Florida corporation, U.S. & FOREIGN MANAGEMENT, LTD., a New York corporation, U.S. & FOREIGN MANAGEMENT, INC., a Florida corporation, BARBARA B. MURPHY, as receiver for each of said corporations.

Defendants.

Filed Nov. 19, 1973 Jacksonville, Fla.

NOTICE OF APPEAL

Notice is hereby given that Defendants, USAFORM HAIL POOL, INC., a Florida corporation, U.S. & FOREIGN MANAGEMENT, LTD., a New York corporation, U.S. & FOREIGN MANAGEMENT, INC., a Florida corporation; BARBARA B. MURPHY, as receiver for each of said corporations, hereby appeal to the United States Court of Appeals for the Fifth Circuit from the Final Judgment and the Findings of Fact and Conclusions of Law in support

thereof, entered in this action on the 2nd day of August, A.D., 1973.

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APPENDIX D

IN THE
UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND, a Maryland corporation,
Plaintiff,

v.

USAFORM HAIL POOL, INC., a Florida corporation; U.S. & FOREIGN MANAGEMENT, LTD., a New York corporation; U.S. & FOREIGN MANAGEMENT, INC., a Florida corporation; BARBARA B. MURPHY, as receiver for each of said corporations,
Defendants.

(Stamped: "Filed Jan. 14, 1974 — Jacksonville, Fla.)

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This action arose out of the financial collapse of a small corporate empire, controlled by F. Wylly Clarke (Clarke), consisting of five corporations, engaged in related businesses of reinsurance brokers, managers of hail insurance pools, and a general insurance agency, in which, with one exception, Clarke owned all of the stock, and in the exception, he owned 50% of the stock.

Background

On August 30, 1963, Fidelity and Deposit Company of Maryland (F & D) brought this action for declaratory judgment against Usaform Hail Pool, Inc. (Hail Pool), U.S. & Foreign Management, Ltd. (Limited), U.S. & For-

eign Management, Inc. (Management, Inc.), and Barbara B. Murphy, as receiver for the three corporate defendants, seeking a judicial determination of the rights and obligations of the parties to a blanket position bond (Clt's Ex. 1, App. pp. 239a-245a), (bond), wherein F & D was named as Underwriter, and Limited, Management, Inc., Hail Pool, Usaform Pan American, Ltd. (Pan American), and Halifax Insurance Agency, Inc. (Halifax), and two other Clarke corporations (not important here), were named as Insured.

After the action was brought, various insurance companies who were shareholders in the hail insurance pool, managed by Hail Pool (pool participants), and who had employed Limited and Pan American as insurance brokers (underwriters group), who were not named as insureds in the bond, made claims on the bond for the loss of their premium moneys allegedly held by Hail Pool, Limited, and Pan American, and sought to intervene in the action as parties defendant in order to assert their claims directly against F & D.

To avoid a multiplicity of suits, and upon a stipulation of the parties, an order was entered on October 3, 1964, which allowed Empire Insurance Company to intervene as the class representative for the pool participants, and Stuyvesant Insurance Company to intervene as the class representative for the underwriters group. The intervenors were ordered to plead to the complaint for declaratory judgment.

All defendants and intervening defendants filed an amended answer, and counterclaims consisting of twelve separate counts.

On motion by F & D, the court, on November 14, 1966, entered summary judgment dismissing Counterclaim Counts I, III, IV, V, VII, IX, X, XI, and XII, on the ground

that there was no genuine issue as to any material fact, and that F & D was entitled to judgment as a matter of law on each of those counterclaim counts.

The court held that neither the pool participants nor the underwriters group had any right of action against F & D on the bond.

On appeal to the Court of Appeals for the Fifth Circuit, that court affirmed the judgment of the district court, and remanded the case for trial on the issues presented by Counterclaim Counts II, VI and VIII. *American Empire Insurance Company of South Dakota, et al.* v. *Fidelity and Deposit Company of Maryland,* 408 F. 2d (5th Cir. 1969), certiorari denied, 396 U. S. 818, 24 L. Ed. 2d 69. The intervening defendants representing the pool participants and underwriters group, except Pan American, are no longer before the Court.

On August 3, 1970, this case went to trial before the Court, without a jury, on the issues presented by Counterclaim Counts II, VI, and VIII. The issues presented by those counts were whether Hail Pool, Limited, and Pan American could recover on the bond, which insured the fidelity of their employees, the amounts which the Insured owed to the pool participants and underwriters group for premium moneys which the Insured had used to pay their operating expenses and other corporate obligations.

The trial proceeded on the legal theory that the bond covered the premium moneys belonging to the pool participants and underwriters group, and that, when the employees of Hail Pool, Limited and Pan American used those premium moneys, alleged to be "trust funds", to pay operating expenses and other corporate obligations of the Insured, they fraudulently embezzled or diverted those premium moneys belonging to the pool participants and

underwriters group. Judgment was entered against F & D and in favor of the Insureds for the debts they owed to the pool participants and underwriters group. *Fidelity and Deposit Company of Maryland* v. *Usaform Hail Pool, Inc., et al.,* 318 F. Supp. 1301 (1970).

F & D appealed from that judgment to the Court of Appeals for the Fifth Circuit, and that court vacated the judgment, and remanded the case to this Court for further consideration and the entry of additional findings on the question whether the moneys taken from the insured companies' premium accounts went to pay legitimate expenses of the respective companies. *Fidelity and Deposit Company of Maryland* v. *Usaform Hail Pool, Inc., et al.,* 463 F. 2d 4 (5th Cir. 1972).

This cause came on for hearing on January 26, 1973, on the written list of claims presented by claimants which they contend represent losses for which they are entitled to recover in light of the legal principles established by the opinion of the Court of Appeals, and on F & D's written response to each of those claims.

The Court having heard the parties, and considered the evidence before the Court in light of the legal principles announced in the opinion of the Court of Appeals, finds the facts and states the conclusions of law, as follows:

Findings of Facts

I

Claims Asserted by Hail Pool.

A. Payment Of Debenture To Clarke In Amount Of $10,000.00. The receiver for Hail Pool claims that the payment of $10,000 to Clarke to redeem a $10,000 debenture is a transfer of funds to him as stockholder, but the evidence in the record shows the fact to be otherwise.

1. Hail Pool was organized on November 18, 1961, with $100,000 capital, consisting of 400 shares of common stock, at $250 per share, all of which were issued to Clarke, and Clarke paid into the corporation $100,000 in cash, which he borrowed from Marine Midland Trust Company of New York, and pledged the stock as security.

2. At the same time, Hail Pool issued debentures, having an aggregate face value of $100,000, which the board of directors authorized to be sold on a discount basis; all of which were purchased by Clarke, and he paid into the corporation a total of $94,200 cash, which he also borrowed from Marine Midland Trust Company and Mercantile National Bank of Miami Beach, and pledged the debentures as security. Thus, the corporation received in its corporate bank account the full purchase price of both the stock and the debentures.

3. On July 10, 1962, Hail Pool drew its check to Clarke for $10,000, in payment of a $10,000 debenture which had become due. On the same date, Clarke drew his own check to the order of Marine Midland Trust Company for $10,000 to apply on the $100,000 loan, and to redeem the debenture, which he returned to the corporation, and the corporation carried it in its balance sheet as an asset.

4. The evidence fails to show that premium moneys were in fact used to redeem the debenture. The debenture was a legitimate obligation of the corporation, and the money was used to pay a legitimate obligation. Clarke was only a conduit through which the payment was made to Marine Midland Trust Company. Hail Pool could not recover on the bond for the $10,000 payment if it were solvent, and had adequate funds to pay all of its debts. The claimants have failed to meet the burden of proof required to prove that this item represents a loss covered by the bond.

B. Two Payments To Clarke Amounting to $2,450.00. The receiver for Hail Pool claims that two checks drawn to the order of Clarke for $1,200 and $1,250, respectively, were moneys diverted to the personal use of Stockholder Clarke, and, therefore, represent a recoverable loss.

1. The mere assertion that the payments to Clarke are fraudulent diversions of funds, without more does not make out an insured loss. The parties have stipulated that the two checks were charged on Hail Pool's books to travel and entertainment expense. The parties are bound by that stipulation.

2. Clarke testified positively, and without contradiction, that the two checks were for travel and entertainment expense. He testified that he did a great deal of traveling in quest of business, and that testimony was corroborated by Grundy and Stebler.

3. Travel and entertainment expense, incurred in quest of business, is a legitimate corporate business expense. There is no evidence that Hail Pool did not get the benefit of the two payments. Hail Pool has sustained no loss as a result of these two payments to Clarke, much less a dishonesty loss.

C. Loan to Halifax In The Amount of $14,000.00. The receiver of Hail Pool claims that the loan to Halifax was a fraudulent diversion of corporate funds to the personal use of Stockholder Clarke, which caused Hail Pool a loss covered by the bond.

1. The mere conclusory statement that the loan was a dishonest and fraudulent diversion of corporate funds, without more, does not suffice to make out an insured loss. Dishonesty and fraud are not presumed, but must be proved by evidence that is clear, cogent, and convincing.

2. The undisputed evidence in the record shows that, on June 11, 1962, Hail Pool drew a check on its general operating account to the order of Halifax for $14,000, and entered the payment in its records as an account receivable from Halifax, and described it as an advance.

3. Clarke was a 50% stockholder of Halifax, and a 100% stockholder of Hail Pool. Halifax had been an affiliated corporation in the Clarke corporate empire since about 1958, and it had been a joint insured in the bond since it became effective on June 30, 1959. It conducted a general insurance agency in Daytona Beach, Florida, and there is evidence in the record that it did produce some business for the other Clarke corporations.

4. Clarke testified positively, and without contradiction, that the purpose of the loan was "to keep Halifax afloat." It was necessary to keep Halifax afloat. Clarke discussed the situation with several of the directors before it was made, and they all thought it was a wise investment at the time. Clarke further testified, without contradiction, that he never received any advances, salary, or expenses from Halifax over the years.

5. Clarke was trying to sell Hail Pool as a going concern about that time for enough money to pay off the creditors of all of the corporations. His testimony that it was necessary to keep Halifax afloat strongly indicates that he was also trying to sell Halifax, for he testified that the value of the agency as a going concern was two and a half times the annual commissions earned on the renewal of the business on the books. If Halifax failed, it would have no value. Similarly, if one member of the corporate complex failed, it would cause the other members to fail, and that, too, would ruin any chance of selling Hail Pool.

6. There is no claim, and no evidence to show, that Hail Pool was prohibited by either its by-laws or its charter from making the loan or advance to Halifax. There is no evidence in the record to show that the loan was not made in good faith, and in the regular course of business. The evidence shows that Hail Pool's stockholders, directors, and officers believed at the time that the loan was in the best interests of Hail Pool.

7. The situation here is very similar to the situation in *Kerr* v. *Aetna Casualty & Surety Co.*, 350 F. 2d 146, 150 (4th Cir. 1965). In that case there were numerous transactions between several of the insured named in the bond, including loans, contributions to capital, advances and commissions. The court held that there was no loss with respect to those items. The court further held that positive acts of wrongdoing against the insured corporations must be shown for there to be a recovery on the fidelity bond (350 F. 2d at p. 151).

8. Certainly the loan to Halifax is not a dishonest and fraudulent diversion of funds per se. The receiver has not met the burden of proof necessary to establish the loan as a dishonesty loss for which there can be a recovery on the bond. On the evidence in the record, Hail Pool could not recover this item as an insured loss, if it were solvent, and had sufficient assets to pay its debts, and the receiver, whose rights are no better, cannot recover.

D. Hail Pool's Advances of $63,331.10 To Limited. The receiver for Hail Pool claims that Hail Pool's advances to Limited are fraudulent diversions of corporate funds to other corporations without legal claims, and, therefore, they constitute an insured loss.

1. Limited's balance sheet at December 31, 1962 showed advances payable to Hail Pool in the amount of $63,331.10, and that appears to be the basis of the receiver's claim for $63,331.10. The ground upon which the receiver claims that those net advances to Limited are fraudulent diversions of Hail Pool funds is that Limited is a corporation solely owned by Clarke. The fact is that Hail Pool, too, is solely owned by Clarke. That fact alone does not make the advances fraudulent.

2. The clear and undisputed evidence shows that there were reciprocal advances between Hail Pool and Limited in 1962. The practice of reciprocal advances between the affiliated corporations was a form of mutual assistance which was of long standing, and it was not wrong per se. These reciprocal advances are clearly debit and credit transactions between the insured. Everything appears on its face to be open, and above board. The certified public accountants who audited the books were unanimous in their testimony on that point. That is the very opposite to dishonest and fraudulent diversions. Concealment is the badge of fraud. Any person who perpetrates a fraud on another does not make an open record of that fact.

3. There is no evidence that any employee of Hail Pool, including Clarke, received any personal benefit from the advances. The transactions were not dishonest or fraudulent per se. If both Hail Pool and Limited were solvent and able to pay their debts in full, the advances would be considered legitimate business transactions between the insured, and Hail Pool could not recover the balance from F & D as a dishonesty loss. The burden is on the receiver to prove positive acts of wrongdoing against the insured corporations and a resulting loss before there can be a recovery, and that burden has not been met here. It is important to keep in mind that the bond insured only the several insured against losses due to acts of dishonesty against the insured, and not the insured's creditors.

E. Payment Of 1961 Pool Debts In Amount of $170,467.18. The receiver for Hail Pool claims that the payment of the 1961 Hail Pool debts out of the 1962 premium moneys is a dishonest diversion of Hail Pool funds to other corporations without legal claim to the funds, and that it is an insured loss.

1. The receiver has adduced no factual evidence to support this claim. There is no factual basis for the claim. On the contrary, the evidence shows clearly that there is no basis for the claim in fact or law under the legal principles which govern this case.

2. By formal contract ratified and approved by Hail Pool's board of directors on November 30, 1961, Hail Pool assumed all liabilities and obligations of Management, Inc., including the 1961 hail pool debts. The 1961 hail pool debts were valid contract obligations of Hail Pool to the same extent as the debt for office rent would be. "(T)he taking of money from the premium account of an insured company to pay other legitimate obligations of that company does not constitute a loss within the meaning of the fidelity bond before us in this case" (463 F.2d at p. 7).

3. There is no evidence to support a charge that any employee of Hail Pool committed a dishonest or fraudulent act in paying the 1961 pool debts. There is no evidence to prove that Hail Pool sustained a loss through such payments. If Hail Pool were a going concern, and financially able to pay its debts, it would not recover on the bond on account of such payments.

4. Positive acts of wrongdoing against Hail Pool must be shown with respect to each of the claimed losses before there can be a recovery on the bond. The Court finds that no such acts have been shown and that all of the claimed

losses to Hail Pool were not caused by any fraud or dishonesty of its employees covered by the bond.

II

Claims Asserted By Limited

A. Limited's Advances To Pan American $237,361.44. The receiver for Limited claims that the advances to Pan American were fraudulent diversions of Limited's funds to Pan American, which make out an insured loss.

1. The receiver asserts a claim for the entire amount shown on Limited's Balance Sheet as of December 31, 1962, which was prepared by Stebler. Greenfield, a certified public accountant, employed by the underwriters group, listed payments by Limited to Pan American over a three year period, aggregating an amount in excess of the amount claimed, which would indicate that there were reciprocal debits and credits between Limited and Pan American, with the net account receivable being shown on the balance sheet, which Limited carried as an asset.

2. In 1959, Limited purchased all of the stock of Pan American's predecessor in name. Thus, Pan American became a wholly owned subsidiary of Limited to engage in the same reinsurance brokerage business as Limited but Pan American would operate in South America. Pan American and Limited occupied the same offices; they shared the overhead and operating expenses; they had identical boards of directors; and their two top officers were the same. Pan American has been a joint insured in the bond since its acquisition by Limited. Saul Greenfield, a certified public accountant employed by the underwriters group, considered that Limited and Pan American had identical interests and that they were one and the same corporations for all practical purposes. He prepared

a combined balance sheet for both corporations as of February 28, 1963.

3. The receiver's evidence adduced at the trial of the case, for the purpose of proving the allegations in Limited's Counterclaim Count VI that "Clarke, acting alone and/or in collusion with other employees of Limited, did fraudulently and/or dishonestly embezzle, steal, (or) divert *** reinsurance premiums *** belonging to the underwriters group," shows only that, in 1960, 1961, and 1962, Limited drew checks on its premium account in Marine Midland Trust Company to the order of Pan American, and nothing more. That evidence is totally insufficient to support the present claim that Limited's employees embezzled, stole, or diverted Limited's moneys from Limited which caused Limited a loss within the meaning of the bond.

4. The evidence shows, without dispute, that the advances to Pan American went to pay the overhead and operating expenses chargeable to Pan American for bookkeeping purposes. The payments must be considered in the same light as if Limited had paid all of the overhead and operating expenses of both corporations by check, and charged Pan American with its pro rata share of those expenses by means of debit and credit memorandums. The better bookkeeping practice is to use checks instead of internal debit and credit memorandums. In either event, the books of Limited would show accounts receivable from Pan American, and Pan American's books would show accounts payable to Limited, and that is exactly what the books of both corporations did show.

5. There is no evidence that any employees personally benefited from the advances. There is no evidence to show that the advances were motivated by fraud or dishonesty on the part of Limited's employees. Fraud and dishonesty are never presumed. The burden is on him who charges fraud and dishonesty to prove them by evidence that is clear and convincing.

6. The claim here that Limited's advances to Pan American caused Limited a loss due to the fraud and dishonesty of Limited's employees is identical with the claim of the trustee for National Discount in *Kerr* v. *Aetna Casualty & Surety Co.*, 350 F.2d 146, 150, 151 (4th Cir. 1965). There, National Discount made advances and loans to Title, its wholly owned subsidiary to enable the latter to stay alive, and operate. The trustee there made the same argument which is made here, but the court held that the claimed losses to National Discount were not due to any fraud or dishonesty covered by the bond. The court held "that positive acts of wrongdoing against the insured corporation must be shown" in order to establish an insured loss.

7. The Court finds that Limited's advances to Pan American were not fraudulent or dishonest diversions of its funds by its employees which caused it a loss covered by the bond. The Court further finds that, if Limited were now solvent, and had sufficient assets to pay its debts in full, it could not recover those advances as losses under the bond, and the receiver, whose rights are no better than Limited's cannot recover.

B. Account Receivable Due From Stockholder $33,163.52. The receiver for Limited now claims that the account receivable from Clarke shown on Limited's Balance Sheet as of December 31, 1962, is a fraudulent diversion of Limited's funds to the personal use of Clarke, which caused Limited a loss due to Clarke's fraud and dishonesty covered by the bond.

1. The balance sheet was prepared by Stebler, Limited's vice president and treasurer, and it lists as an asset, "Due

from stockholder $33,163.52." On its face, the account receivable is a debit and credit transaction between Clarke and Limited. There is no coverage under the bond for debit and credit transactions.

2. The bond covers only losses caused by the fraudulent or dishonest acts of the Insured's employees. Clarke testified by deposition, without contradiction, that he owed Management, Inc. and Limited approximately $150,000 on account of loans obtained from them over a period of time from about 1954 to the end of 1961, and that the $150,000 figure represented the cumulative amount of the several loans. Clarke testified that the purpose of the loans was to pay income taxes. Stebler testified that the account receivable on Limited's books represented advances to Clarke over a period of time. Clarke also testified, without contradiction, that his salary for all three operating corporations was set at $37,500 per year, but he had never drawn the full salary, and in 1962, he testified that he and his wife together were paid only $30,000 as salary. Clarke further testified that, in 1962, he had incurred traveling expenses in behalf of the three corporations which amounted to between $25,000 and $30,000, which he personally paid out of his own pocket, and for which he had not been reimbursed.

3. Barbara Murphy, testifiing in her own behalf, stated that she actually handled Clarke's personal bank account; that she deposited his checks in the bank account; that she drew checks on that account in payment of his household bills; that she reconciled his bank statements with the cancelled checks; and that, in handling Clarke's personal affairs, she saw no evidence that Clarke had committed any acts of impropriety against the corporations. She testified that Clarke "was going all over the country trying to sell the hail pool business; and he even applied to the Small

Business Administration for loans to try to pay off all creditors." She testified in addition that Clarke took no money from the corporations improperly, and that he was not dipping into the tills. The conduct described by Clarke and by Murphy, which stands uncontradicted, does not equate with fraud and dishonesty.

4. No one has ever claimed, or even suggested, that the advances were not entirely legitimate transactions when made. Each advance was clearly recorded on Limited's records by someone other than Clarke, and they appeared on the books for all to see. The advances were not fraudulent per se. Fraud and dishonesty are never presumed. He who charges fraud or dishonesty must prove the charge by evidence that is clear and convincing. Positive acts of wrongdoing against Limited must be shown in order to make out an insured loss. The Court finds that there is no evidence to support this claimed loss to Limited which is due to any fraud or dishonesty covered by the bond. The Court further finds that, if Limited were now solvent, and had assets with which to pay its debts in full, it could not recover such advances under the bond, and the receiver, whose rights are no better than Limited's cannot recover.

C. Loan Receivable $10,145.90. The receiver for Limited claims that a loan receivable shown on Limited's Balance Sheet as of December 31, 1962 in the amount of $10,145.90 is a fraudulent diversion of Limited's funds to the personal use of its employees which caused it a loss covered by the bond.

1. The only evidence of this loan receivable is Limited's Balance Sheet as of December 31, 1962, which was prepared by Stebler, Limited's vice president and treasurer. Although the receiver for Limited examined Stebler by deposition on the balance sheet at the trial, Stebler was not questioned about this loan receivable. The only evidence

about it is that it appears on the balance sheet. There is no evidence to show when or how the loan originated, to whom it was made, or that it was made to an employee of Limited. In any event, it was carried on Limited's books as an asset, which is the opposite of a loss.

2. There is no evidence to show any factual basis for the bald, conclusory assertion that the loan receivable is a fraudulent diversion of Limited's funds to the personal use of an employee. There is no evidence to show that Limited was involuntarily deprived of the proceeds of the loan. On the record, it appears to be a legitimate and bona fide transaction.

3. The Court finds no evidence to show any positive acts of wrongdoing against Limited with respect to this claim, and that the claimed loss to Limited does not result from any act of fraud or dishonesty covered by the bond. If Limited were solvent, and had assets sufficient to pay its debts in full, it could not recover this item of claim under the bond, and the receiver, whose rights are no better than Limited's cannot recover.

D. Limited's Advance To International $1,333.84. The receiver for Limited now claims that a check drawn by Limited on the premium account in Marine Midland Trust Company to the order of Usaform International, Ltd. for $1,333.84 is a fraudulent diversion of Limited's funds to International which caused Limited an insured loss.

1. The check appeared on a list of checks prepared by Saul Greenfield at the receiver's request to show Limited's transfers of funds from the premium account to Limited's operating account, or to pay other obligations of Limited, on the theory that such transfers constituted embezzlement or theft by Limited of "trust funds" which made out an insured loss. That theory has been rejected by the Court

of Appeals, and the check, standing alone, provides no evidence that it was a fraudulent or dishonest diversion of funds which caused Limited a loss within the meaning of the bond.

2. There is no evidence in the record to show that the check was not in payment of a perfectly legitimate account owed by Limited to International. Fraud and dishonesty cannot be presumed. The burden is on him who charges fraud and dishonesty to prove the charge by evidence that is clear and convincing. The Court finds that positive acts of wrongdoing against Limited have not been shown, and that this claimed loss to Limited does not result from any act of fraud or dishonesty which is covered by the bond. If Limited were solvent, and had assets with which to pay its debts in full, it would not be able to recover this item of claim as a loss under the bond, and the receiver whose rights are no better than Limited's cannot recover.

III

Claims Asserted by Pan American

A. Pan American's Advances To International $11,600.00. Pan American claims that eleven checks which were drawn on its premium account in Marine Midland Trust Company, payable to International are fraudulent diversions of its funds to International, which caused it a loss covered by the bond.

1. The evidence in the record shows only that International was a European corporation formed for the purpose of handling the European and world wide reinsurance brokerage business for Limited and Pan American; that the corporation was organized by a trust company in Switzerland, which put up the money for the stock, and the trust company held the stock for the benefit of Limited;

that the relationship between Limited and Pan American on the one hand, and International on the other hand, was that Limited and Pan American managed International; and that there were transfers from the premium account to International to cover the overhead of its office in Zurich, Switzerland.

2. The evidence further shows that the transfers complained of here are included in Limited's advances to Pan American to enable Pan American to pay International's operating expenses. Thus, Pan American was no more than a mere conduit through which Limited paid International's overhead and operating expenses. The evidence is clear that Pan American could have no loss on account of the advances to International, much less a fraud or dishonesty loss.

3. The Court finds no evidence to support this claimed loss to Pan American which was caused by any act of fraud or dishonesty covered by the bond.

B. Pan American's Advances To Clarke and Stebler $11,600.00. Claim is now made in behalf of Pan American that twenty-one checks drawn by Pan American on its premium account in Marine Midland Trust Company to the order of Clarke and Stebler during the year, 1962, amounting in the aggregate to $11,600 are fraudulent diversions of Pan American's funds to the personal use of Clarke and Stebler, which caused Pan American an insured loss.

1. There is no evidence in the record to support this claim. Fraudulent and dishonest diversion of funds cannot be presumed from the sole fact that the payments were made out of the premium account in Marine Midland Trust Company. There is no evidence whatever to show the purpose of the payments. The payments are not charged on Pan American's records to Clarke and Stebler personally.

In light of the meticulous entries of all advances kept by the three corporations, the absence of any charges of the payments to Clarke and Stebler strongly indicates that the payments were for legitimate purposes. The uncontroverted testimony of Stebler is that he received nothing from either Limited or Pan American, except his salary.

2. The uncontradicted evidence further shows that the payments now complained of are included in Limited's advances to Pan American to enable Pan American to pay its share of the overhead and operating expenses. Pan American was no more than a conduit through which Limited made the payments for the overhead and operating expenses. Those payments are wash transactions, and the Court of Appeals has held that such transactions do not make out insured losses. *Fidelity and Deposit Company* v. *Usaform Hail Pool, Inc.*, 463 F. 2d 4, at p. 6; *Kerr* v. *Aetna Casualty & Surety Co.*, 350 F. 2d 146, 150 (5th Cir. 1965).

3. The Court finds that there is no evidence to support this claim that the payments to Clarke and Stebler caused a loss to Pan American due to any acts of fraud or dishonesty covered by the bond. The Court further finds that, if Pan American were now solvent, and had sufficient assets to pay its debts in full, it could not recover those payments as a loss under the bonds. Its insolvency does not improve its situation against the bonding company.

Conclusions of Law

Since jurisdiction is based on diversity of citizenship, 28 U.S.C.A., § 1332, the case is controlled by Florida law.

The bond in this case was written to indemnify the insureds against loss which the insureds shall sustain through any fraudulent or dishonest act of their employees, not losses sustained by the insureds' creditors. *Fidelity*

and Deposit Company of Maryland v. *Usaform Hail Pool, Inc., et al,* 463 F. 2d 4, 5 (5th Cir. 1972); *Kerr* v. *Aetna Casualty & Surety Co.,* 350 F. 2d 146, 150 (4th Cir. 1965).

Fraud and dishonesty are never presumed and the burden of proving fraud and dishonesty is on the party who asserts it. *Biscayne Boulevard Properties, Inc.* v. *Graham, Fla.,* 65 So. 2d 858. Proof of fraud and dishonesty must be clear and convincing. *Middleton* v. *Plantation Homes, Inc., Fla.,* 71 So. 2d 503; *Biscayne Boulevard Properties, Inc.* v. *Graham, supra; Graessle* v. *Shultz,* 90 So. 2d 37, 38 (Fla. 1956).

In this case, the receiver for Hail Pool and Limited, and Pan American are the parties who have asserted that the claimed losses to each of them are caused by acts of fraud and dishonesty on the part of their employees in fraudulently diverting their funds to the personal use of employees, amounting to embezzlement or theft, or diverting their funds to others, which also amount to embezzlement or theft from the insured corporations. The burden is on Hail Pool, Limited, and Pan American to prove the acts of fraud or dishonesty by affirmative proof that is clear and convincing. The burden is not on F & D to prove that the claimed losses to each of the insured corporations was not caused by acts of fraud and dishonesty covered by the bond.

In order to show personal "fraudulent or dishonest acts" within the meaning of the bond, there must exist a compelling sense of conscious wrong rather than mere omission or act amounting to negligence. *Sade* v. *National Surety Corp.,* 203 F. Supp. 680, 684 (D.D.C. 1962), affirmed, 314 F. 2d 286 (D.C. Cir. 1963).

In order to recover on the bond before use in this case, positive acts of wrongdoing against the insured corporations must be shown. *Kerr* v. *Aetna Casualty & Surety Co.,* 350 F. 2d 146, 151 (4th Cir. 1965).

"The case must be viewed as if the insured companies were solvent and had adequate funds in their general accounts to replace the money diverted from the premium accounts. If the insureds cannot recover on the bond in that situation, their insolvency does not improve their case against the bonding company." *Fidelity and Deposit Company of Maryland* v. *Usaform Hail Pool, Inc., et al.,* 463 F. 2d 4, 5 (5th Cir. 1972); *Scott* v. *Armstrong,* 146 U.S. 499, 507, 13 S. Ct. 148 (1892); *Fidelity & Casualty Co. of New York* v. *Hoyle,* 64 F. 2d 413, 415 (4th Cir. 1933).

In order to recover on the bond in this case, it is necessary to prove first of all that the employees committed fraudulent and dishonest acts which caused the insureds a loss. Fraud and dishonesty are questions of fact which must be proved by evidence that is clear and convincing. They are not matters of law.

When the claims now asserted in behalf of Hail Pool, Limited, and Pan American are considered in light of the evidence in the record and the controlling principles of law, it is clear that the claimants cannot prove any affirmative acts of wrongdoing against the insured corporations. They cannot meet the standards which have been established to govern disposition of the case.

It is equally clear that bald, conclusory assertions of fraud and dishonesty, without more, will not establish fraud or dishonesty. The claimants have not pointed out any evidence in the record which will provide clear and convincing proof of the fraudulent or dishonest acts which they have asserted.

At the hearing on this case, the claimants cited several cases which they claimed supported their assertion of

fraudulent and dishonest acts connected with each of the transactions now claimed to have resulted in a loss which is covered by the bond.

The first case relied on by the claimants is ***Maule Industries*** v. *Gerstel,* 232 F. 2d 294 (5th Cir. 1956), which arose out of a bankruptcy proceeding, and it involved a petition by a creditor for a turnover order, requiring a corporation and its receiver to turn over the property of the corporation to the trustee of another bankrupt corporation. The petition alleged that the second corporation was controlled and directed by the first (bankrupt); that the second corporation had substantially the same officers, directors and stockholders, and that the second corporation was an instrumentality of the bankrupt corporation. The turnover order was denied, and the court said, (232 F. 2d at 297):

> "The burden in this case is upon Maule (the petitioning creditor) to establish by pleadings and proof that Ludwig Bros., Inc. is 'an artifice and a sham designed to execute illegitimate purposes in abuse of the corporate fiction and the immunity that it carries.'"

That case is not in point with the situation involved here, but on the question of fraud and dishonesty, the court reaffirmed the rule that the burden is on the party asserting fraud or dishonesty in any form to prove the charge by evidence that is clear and convincing.

Wooddale v. *Fidelity and Deposit Co.,* 378 F.2d 627 (8th Cir. 1967), was an action on a fidelity bond, and the only question involved there was whether the culprit was an employee of the insured, or not. There, the piercing of the corporate veil doctrine was mentioned only indirectly. The court simply held that, in order to pierce the corporate veil, one must allege and prove that the corporation was organized for purposes of fraud. The only purpose in trying to pierce the corporate veil is to allow a creditor to go behind the corporation, and recover from the sole stockholder the amount of the corporate debt to the same extent as if the debt had been incurred by the stockholder as an individual. That has nothing to do with this case, for this is an action to recover on a fidelity bond for losses caused by the alleged fraudulent and dishonest acts of employees of the insured corporations.

Corsicana National Bank v. *Johnson,* 251 U.S. 68, 40 S. Ct. 82 (1919), was an action by a bank against its former director and vice president on a statutory cause of action which makes the directors liable to the bank for making illegal or excessive loans. That case is of no help whatever to the claimants in this case. This is not an action against the directors of the insured corporations, but an action to recover on a fidelity bond protecting the insured corporations against the acts of their employees.

Geddes, et al. v. *Anaconda Copper Mining Co.,* 254 U.S. 590, 41 S. Ct. 209 (1921), was an action by minority stockholders of a corporation to set aside a sale of the corporate assets to another corporation. The two corporations had a common director on both boards. That case has no application whatever to the situation involved here, for no stockholder has attacked any transactions complained of. Neither corporation has attacked any of the transactions involved. That case is distinguishable from this case both on its facts and its law.

Finally, *Pepper* v. *Litton,* 308 U.S. 295, 60 S. Ct. 238, 84 L. Ed. 281 (1939), arose out of a bankruptcy proceeding, and involved the question whether the bankruptcy court could disallow either as a secured or as a general or unsecured claim a judgment obtained by the dominant and controlling stockholder of the bankrupt corporation on alleged

salary claims. It involved a scheme in fraud of creditors, and the bankrupt trustee sought to set it aside. Again, that case has absolutely no applicability to anything involved in this action.

Here, no creditor has sought to set aside any transaction. No creditor has sought to pierce the corporate veil, and recover the alleged losses from Clarke as the sole stockholder. No creditor has attacked the validity of any transactions involved between the corporations.

This is an action on a fidelity bond to recover losses alleged to have been sustained through fraudulent or dishonest acts of the insureds' employees. The receiver for Hail Pool and Limited, and Pan American have not met the burden of proof required to show that their claimed losses are caused by acts of fraud and dishonesty covered by the bond.

On the evidence, considered in light of the legal principles which govern this case, the Court concludes that Barbara B. Murphy, as receiver for Usaform Hail Pool, Inc., Barbara B. Murphy, as receiver for U.S. & Foreign Management, Ltd., and Usaform Pan American, Ltd., are not entitled to recover anything against Fidelity and Deposit Company of Maryland under the bond. Accordingly, Counterclaim Counts II, VI and VIII are dismissed with prejudice. Judgment will enter in favor of Fidelity and Deposit Company of Maryland dismissing the counterclaim counts.

DONE AND ORDERED at Jacksonville, Florida, this 2nd day of August, 1973.

s/ CHARLES R. SCOTT,
Judge

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IN THE
UNITED STATES DISTRICT COURT FOR
THE MIDDLE DISTRICT OF FLORIDA
JACKONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,
a Maryland corporation,

Plaintiff,

v.

USAFORM HAIL POOL, INC.,
a Florida corporation;
U. S. & FOREIGN MANAGEMENT, LTD.,
a New York corporation;
U. S. & FOREIGN MANAGEMENT, INC.,
a Florida corporation;
BARBARA B. MURPHY,
as receiver for each of said corporations,

Defendants,

Stamped: " F I L E D Aug. 2nd, 1973 — Jacksonville, Fla."

FINAL JUDGMENT

This cause came on for final hearing before the Court and findings of fact and conclusions of law having been filed herein, it is therefore,

ORDERED AND ADJUDGED:

That Barbara B. Murphy, as receiver for Usaform Hail Pool, Inc., Barbara B. Murphy, as receiver for U.S. & Foreign Management, Ltd., and Usaform Pan American,

Ltd., do have and recover nothing; that Counts II, VI and VIII of the counterclaim be dismissed on their merits, with prejudice; and that plaintiff Fidelity and Deposit Company of Maryland do have and recover of and from defendants its costs to be hereinafter taxed by the Clerk.

DONE AND ORDERED at Jacksonville, Florida, this 2nd day of August, 1973.

s/ CHARLES R. SCOTT,
Judge

APPENDIX E

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 31046

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND
Plaintiff-Appellant-
Cross Appellee,

VERSUS

USAFORM HAIL POOL, INC., Et Al.,
Defendants-Appellees-
Cross-Appellants.

Appeal from the United States District Court for the
Middle District of Florida

(July 3, 1972)

Before TUTTLE, INGRAHAM and RONEY,
Circuit Judges

RONEY, Circuit Judge: This case started out as a suit for declaratory decree brought by a bonding company, Fidelity and Deposit Company of Maryland, to determine its liability on a fidelity bond. After a prior appeal which affirmed a summary judgment against various intervenors

who were not named in the bond,[1] the action proceeded on the counterclaims filed on behalf of three insured corporations, two of which were in receivership. The suit was heard as though these insureds were plaintiffs and F & D the defendant. Judgments were entered against F & D in the total amount of $918,919.43. F & D thinks this is too much. The three claimants think it is not enough, and cross-appeal on the ground that they should have been awarded punitive damages. Because the district court used the wrong standard of law in determining the amount of liability on the bond, we reverse and remand for further consideration. We affirm the denial of punitive damages as having been determined by the prior appeal.

I

Liability on the Bond

The facts of this case are well summarized in the prior opinion of this Court, reported at 408 F.2d 72, (5th Cir. 1969), and need not be restated here. It is sufficient to say that the acts of infidelity of employees upon which F & D's liability on its bond was predicated consisted of alleged misuse of funds being held by the insured corporations in a special "premium account." The district court viewed this account as a trust fund. However, the funds were used to pay corporate obligations, not for trust purposes.

The critical question determinative of this appeal is whether the claimants can recover on a bond insuring the fidelity of their employees when the employees took nothing from the claimant corporations, but used "trust" funds to pay legitimate corporation obligations. We hold that they cannot.

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[1] *American Empire Ins. Co. of S. Dak.* v. *Fidelity & Deposit Co. of Md.*, 408 F.2d 72 (5th Cir. 1969).

We reach this decision on the ground that the insureds suffered no loss from the use of money used to pay just corporate debts.

The fact that must be remembered in this case is that the bond was written to protect against loss to the insureds, not the losses of third parties.[2] The case must be viewed as if the insured companies were solvent and had adequate funds in their general accounts to replace the money diverted from the premium accounts. If the insureds cannot recover on the bond in that situation, their insolvency does not improve their case against the bonding company.[3]

The controlling principle of law was enunciated by this Court in *Continental Casualty Co.* v. *First National Bank of Temple*, 116 F.2d 885 (5th Cir. 1941). In that case, funds had been dishonestly withdrawn by bank employees from the accounts of bank customers. When subsequent deposits were made by other customers, credits for the amounts of such new deposits were given to the accounts from which withdrawals had been made, and the deposit slips were withheld from the records of the bank, so that the books would balance. However, such new deposits only served to cover up the previous withdrawals and the liability of the bank remained the same, being simply switched from the old to the new deposits.

We held that the withholding of deposit slips in these circumstances caused the bank to suffer no loss, because its

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[2] In the prior appeal, Judge Dyer, speaking for the Court said:

> "We are of the firm view that F & D's contract meant just exactly what it clearly said, that is, that it insured the named corporations and those corporations only, against the defalcations of their employees." 408 F.2d at 77.

[3] *Scott* v. *Armstrong*, 146 U.S. 499, 507, 13 S.Ct. 148 (1892); *Fidelity & Cas. Co. of N.Y.* v. *Hoyle*, 64 F.2d 413, 415 (4th Cir. 1933); *McKee* v. *American Cas. Co. of Reading, Pa.*, 316 F.2d 428 (5th Cir.), *cert. den.*, 375 U.S. 830, 84 S.Ct. 75 (1963)

assets were neither increased nor diminished. We said there that a loss would only result from some action which reduced the available assets in the hands of the bank as against its liabilities to depositors, creditors, and stockholders.

The same conclusion was reached by the Fourth Circuit in *In re Schluter, Green & Co.,* 93 F.2d 810 (4th Cir. 1938). There a dishonest brokerage house employee had sold customers' securities without authorization from the customer, and had taken money from customers without buying the securities ordered by the customer. The Court said:

> "The conduct of Miss Seay [the employee] may fairly be described as dishonest or criminal; but it does not follow that thereby the company suffered a loss. On the contrary, it appears that the money derived from her unlawful behavior was deposited in the company's bank account, and, unless the company thereafter lost the funds as the result of dishonesty or criminal conduct, the company suffered no detriment." 93 F.2d at 812.

The same Court has held that neither wash transactions nor frauds on creditors make out insured losses. *Kerr* v. *Aetna Casualty & Surety Co.,* 350 F.2d 146 (4th Cir. 1965).

In this case, before the diversion of the trust funds, the claimants owed legitimate coporate obligations to third parties. After the funds were diverted from the premium accounts to pay the obligations, the corporations no longer owed the original creditors, but instead owed the same amount to the beneficiaries of the premium accounts from which funds had been diverted. The corporate obligations remained the same in amount and the corporate assets remained the same. Absent sufficient corporate assets to refund the premium accounts, the premium account beneficiaries suf-

fered a loss but no greater than the other creditors would have suffered if they had not been paid.

The district court relied on a series of cases which are all distinguishable from the case now before us. In *Franklin Savings and Loan Co. of Macon* v. *American Employers Insurance Co.,* 99 F. 2d 494 (5th Cir. 1938), the fraudulent acts consisted of the paying of dividends in preference to corporate debts, to make the stock more saleable. Under state law it was a crime to pay a dividend out of funds other than "net earnings," or where the payment increased the corporation's debts. We held that there was a loss to the corporation when funds were distributed to stockholders, to whom there was no legal obligation, and made unavailable to pay the corporate debts. This differs from this case where the funds were used to reduce corporate indebtedness.

In *Glens Falls Indemnity Co.* v. *National Floor & Supply Co.,* 239 F. 2d 412 (5th Cir. 1956), the insured company suffered an inventory shortage due to the misfeasance of its warehouse employee. The issue before the Court was whether or not the employee had acted "dishonestly." There was loss of corporate assets.

Insurance Co. of North America v. *Greenberg,* 405 F.2d 330 (10th Cir. 1969), was a case in which the defrauded party, Greenberg, had purchased the accounts receivable of the Oklahoma Steel Corporation. The corporation was to hold money received on these accounts in trust for Greenberg, but did not do so. The crucial difference between that case and the present situation is that Greenberg, the defrauded third party creditor, was *named insured* under the fidelity bond of Oklahoma Steel.

In *Duel* v. *National Surety Corp.,* 64 F.Supp. 961 (E.D. Wisc. 1945), the insured under the fidelity bond was an

insurance company. Its general agent caused premiums due to be assigned to a corporation which was under his control. Thus the premium money went not to pay legitimate debts of the insured company, but into the pockets of the double-dealing employee.

Genesee Wesleyan Seminary v. *United States Fidelity & Guaranty Co.,* 247 N.Y. 52, 159 N.E. 720 (Ct. of Appls. N.Y. 1928), involved an improper commingling of funds by the bonded employee and expenditures for improper purposes that resulted in a clear loss to the insured.

We hold that the taking of money from the premium account of an insured company to pay other legitimate obligations of that company does not constitute a loss within the meaning of the fidelity bond before us in this case. Since the findings of the district court were not addressed specifically to the question of whether funds taken from the insured companies' premium accounts went to pay legitimate expenses of the respective companies, we vacate the judgment entered below and remand the case for further consideration and the entry of additional findings of fact. It goes without saying that any funds diverted to the personal use of the employees, to other corporations without legal claims, or for any purpose at all that was not for a legitimate corporation purpose would represent a loss to the corporation, and the claimants would be able to recover for such amounts. Rather than try to rely on findings made under wrong principles of law to conclude the case here, the better part of justice is to remand the case for reconsideration of the amount to which claimants are entitled, if anything, in the light of the correct legal principles as announced in this opinion. We have carefully reviewed all other grounds asserted by appellant and affirm the district court in all other respects.

II

Punitive Damages

The three insured companies all included in their counterclaims prayers for punitive damages. These claims for punitive damages were specifically dismissed by the district court when it entered summary judgment against the intervenors. By cross-appeal the insured companies now challenge the correctness of the district court's ruling.

In our previous opinion we made no explicit reference to the district court's dismissal of the punitive damage claims. The issue was raised by the notice of appeal, however, and we affirmed the order of the district court.

The cross-appellants, therefore, are entitled to no relief. Our affirmance on the prior appeal is conclusive as to the entire order appealed from, even those issues as to which no point was made on appeal. *Gulf Coast Building & Supply Co.* v. *Int. Brotherhood of Electrical Workers,* F.2d (5th Cir. 1972) [No. 71-1865, May 12, 1972].

VACATED and REMANDED in part;
AFFIRMED in part.

Adm. Office, U.S. Courts – Scofields' Quality Printers, Inc., N.O., La.

APPENDIX F

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT
COMPANY OF MARYLAND,

Plaintiff,

v.

USAFORM HAIL POOL, INC., et al.,

Defendants.

OPINION

Fidelity and Deposit Company of Maryland, hereinafter called F. & D., sought a Declaratory Judgment to have its liability determined on a fidelity bond issued by it to certain named corporate insureds. Third parties not named in the bond but who claimed to have interests protected by the bond, intervened in the suit. This Court entered a summary judgment against the intervenors. Upon appeal, that ruling was affirmed. American Empire Insurance Co. v. Fidelity & Deposit Co. of Md., 408 F.2d 72 (CA 5th 1969).

The bond was given to insure the named corporate insureds against loss through fraudulent or dishonest acts committed by the insureds' employees. As counterclaims had been filed on behalf of three of the insured corporations seeking to recover sums totaling $631,172.22, procedurally the action continued, following the appeal, as though the claimants were plaintiffs and F. & D. the defendant.

Claimants based their right of recovery on a variety of alleged fraudulent and dishonest acts on the part of F. Wylly Clarke, Jr., an employee of the insured corporations. As a result of extensive pre-trial stipulations, the issues of this very complex case have been narrowed and simplified. There is no substantial dispute concerning the facts, and these efforts of counsel for both sides have been of immeasurable assistance to the Court.

The bond issued by F. & D., for which a premium was charged, included as named insureds USAFORM Pan American Ltd. (Pan-American), USAFORM Hail Pool, Inc. (USAFORM), U.S. & Foreign Management, Ltd. (Limited), and U.S. & Foreign Management, Inc., who with Barbara B. Murphy as Receiver for the last three named corporations, were the defendants named in the Complaint.

U.S. & Foreign Management, Inc. was USAFORM's predecessor corporation in the operation of Clarke's crop hail insurance business. As it was not active when the claimed losses occurred, no claim was submitted on its behalf.

USAFORM was organized in November of 1961. During its first and only crop year, 1962, it acted as manager of a pool created by certain insurance companies (pool participants) to cover hail storm damage to crops owned by farmers who were insureds of these pool participants. USAFORM collected the insurance premiums for the pool participants and deposited the premiums in a segregated trust account which belonged to the participants. Under the pooling arrangement, USAFORM was to pay, on behalf of the pool participants, losses to farmers and expenses of the pool, deduct its commissions, and, at the end of the pool's operating year, remit the balance in the premium account to the participants. Thus, each pool year was a self-contained operation, commenced and completed in one year and involving only one growing season. The function of USAFORM was that of a manager and it sold no insurance of its own.

Limited and Pan-American likewise sold no insurance but acted as intermediaries between insurance companies desiring to reinsure or "cede" portions of their liability under insurance policies and insurance companies desiring to reinsure portions of the liability under such insurance policies. The reinsurance premiums payable to the reinsuring companies were delivered to Limited and Pan-American for transmittal to the reinsuring companies. By reason of the numerous transactions, there was a constant balance of such reinsurance premium monies on deposit with Limited and Pan-American. These premium monies belonged to the insurance companies (underwriters group) doing business with Limited and Pan-American. Under Sections 125 and 5, Insurance Law, Volume 27, McKinney's Consolidated Law of New York, which were stipulated into the record and which governed the operation of these two companies, premium monies received by Limited and Pan-American were held in a fiduciary capacity, and were required to be deposited in an account separate from the corporation's own funds. Violation of this anti-commingling section is a crime.

The evidence is undisputed that these insured corporations had the following in common: Clarke was the sole stockholder, alter ego and chief executive officer of each, and clearly dominated each of them; each was a named insured in the bond; each was in possession of substantial amounts of premium monies belonging to insurance companies; and each was found to have substantial shortages in its premium accounts.

On February 18, 1963, USAFORM was placed in receivership by order of the Circuit Court, Flagler County, Florida. An audit of the books of USAFORM disclosed a shortage of premium monies belonging to pool participants in the amount of $311,624.58. The Circuit Court placed Limited in receivership on the same date. An audit of the books of Limited disclosed a shortage of $277,308.43 in premium monies belonging to insurance companies doing business with it. An audit of the books of Pan-American disclosed a shortage of premium money deposits belonging to insurance companies in the amount of $42,239.21. The audit reports were admitted into evidence by stipulation of the parties and the evidence submitted at the trial substantiated the amounts of the shortages therein disclosed.

F. & D.'s bond was a printed Blanket Protection Bond, undertaking to indemnify the named insureds against any loss of money sustained as a result of any fraudulent or dishonest acts committed by any employee of the insureds acting alone or in collusion with others. The coverage provided was $100,000.00 as to each employee involved in such covered losses, plus $400,000.00 of excess coverage. The salient portions of the sections of the bond involved in this suit are these:

> "Section 5. The insured property may be owned by the Insured, or held by the Insured in any capacity whether or not the Insured is liable for the loss thereof, or may be property as respects which the Insured is legally liable."

> "Section 6. The coverage of this Bond shall not apply to any Employee from and after the time that the Insured or any partner or officer thereof not in collusion with such Employee shall have knowledge or information that such Employee has committed any fraudulent or dishonest act in the service of the Insured or otherwise . . ."

> "Section 7. Upon knowledge or discovery of loss under this Bond, the Insured shall (a) give notice thereof as soon as practicable to the Underwriter or any of its authorized agents, and (b) file detailed proof of loss, duly sworn to, with the Underwriter within four months after the discovery of loss. . . ."

> "Section 12. This Bond shall be deemed cancelled as to any Employee: (a) immediately upon discovery by the Insured, or by any partner or officer thereof not in collusion with such Employee, of any fraudulent or dishonest act on the part of such Employee; . . ."

The significance of these provisions will hereinafter become apparent.

Barbara Murphy, as Receiver, notified F. & D. by letter dated February 22, 1963, that claims under the bond would be made on behalf of the named insureds. The letter was referred to Ralph O. Barnett, F. & D.'s Assistant Claims Manager, an experienced claims attorney, having been in F. & D.'s claim department for 43 years. He dispatched W. P. Rossiter, an attorney in the employ of F. & D., to Daytona Beach for an on-the-spot investigation. Rossiter made at least two detailed reports of his findings to Barnett. Parts of these reports are in the record (R. 224-254) and outlined the claims that the Receiver would make.[1] In mid-March, 1963, he reported to Mr. Barnett that there was no doubt that Clarke had "gutted" the insured corporations.

Mr. Barnett then personally came to Daytona Beach on August 9, 1963, and was shown all the records then in

[1] Reference in this Opinion to "(R.)" are to the printed record on the first appeal of this case to the United States Court of Appeals for the Fifth Circuit. Parts of this printed record were included in the trial record of this cause as Claimants' Compound Exhibit 1 and reference is made to the printed record for convenience.

possession of the Receiver, and on August 30, 1963, F. & D. commenced this action. It has been stipulated that no issue is raised as to the timely filing of proofs of loss on behalf of all three corporations.

Against this factual background, the parties entered into a series of pre-trial stipulations which the Court confirmed and which provided for admission into evidence of a mass of documentary and other evidence, including the pertinent portions of the printed record on the aforesaid appeal.

The issues presented for determination in this suit, some factual, some legal, and some mixed, are these:

1. Whether there were fraudulent or dishonest acts committed by employees of the insured corporations, as those terms are used in the bond, and if so, by whom.

2. Whether the losses resulting from Clarke's actions were such losses as are contemplated by the bond.

3. Whether the fact that Clarke was the alter ego of the insured corporations eliminated F. & D.'s liability for loss occasioned by Clarke's dishonesty.

4. If the insured corporations had "officers" other than Clarke within the meaning of the bond, (i) whether these "officers" had knowledge of Clarke's dishonesty, and if so (ii) whether those other "officers" acted in collusion with Clarke. (i.e. whether coverage as to Clarke's misdeeds was lost through application of the knowledge and discovery provisions contained in sections 6, 7 and 12 of the bond)

5. The amount of coverage furnished by the bond.

6. The amount of interest to be allowed to claimants.

The parties entered into a pre-trial stipulation that as a matter of fact and law Clarke was the sole stockholder

and alter ego of the named insureds. It was also stipulated that as a matter of fact and law, Clarke was a covered employee under the bond and that the bond was in full force and effect at all times material to this suit.

1. Fraudulent and Dishonest Acts.

F. & D.'s first contention is that the claimants have not related specific loss transactions to specific acts of dishonesty. This contention is without merit.

In the case of Usaform, the evidence showed that prior to April 7, 1962, only 10% or 15% of the premiums for the 1962 season had been received. From that latter date, which was the effective date of the bond rider adding Usaform as a named insured, until the corporation went into receivership on February 23, 1963, Usaform received over $3,900,000.00 of premium monies which it obligated itself to maintain in a segregated trust account entitled "Hail Account". It could, by contract with the the pool participants, pay from these premium monies only authorized pool expenses, and its commissions, which totaled approximately $130,000.00 for the year. In writing to F. & D. (R. 59) and the pool participants (R. 66), Clarke made it clear that the premium account was a trust fund belonging to the pool participants. In testifying, William Grundy and Barbara Murphy likewise made it clear that these funds were trust monies. The unrefuted evidence shows that the following unauthorized disbursements were made from the Hail Account belonging to the pool participants:

Repayment to First Atlantic National Bank of a portion of a loan made to the corporation, presumably for corporate operating expenses, in excess of	$ 70,000.00

Payments on account of debts for a 1961 hail pool, which debt had been assumed by USAFORM from another Clarke corporation, in excess of	170,000.00
Transfers to USAFORM's regular corporation account in excess of commissions to which it was entitled, in excess of	178,000.00
TOTAL UNAUTHORIZED EXPENDITURES	$418,000.00

The uncontradicted evidence is that the transfers from the premium account, outlined above, occurred after April 7, 1962. The audit of the "Hail Account" made by Singleton L. Greene, C. P. A., following the collapse of the Clarke corporations, disclosed a shortage in the Hail Account of $339,909.40. The Receiver applied certain credits against this to reduce her claim to $311,624.58. F. & D. introduced into evidence a report made by one of its employees, George J. Riggs, who apparently, in cooperation with another accountant, made an investigation after the collapse. Riggs questioned the inability of USAFORM to restore these funds to the Hail Account, noting that USAFORM appeared to have over $600,000.00 of other assets. The only support for Riggs' contention is a pro forma balance sheet introduced at the trial which listed as an asset "good will" of $780,000.00, giving USAFORM a surplus of $600,000.00. If the illusory asset, good will, was removed from the balance sheet, USAFORM was in a deficit position. The undisputed testimony from Donald P. Zima, a certified public accountant called by Claimants, was that USAFORM was totally insolvent at the time of its organization at which time its assumed liabilities exceeded its assets by more than $175,000.00, and that at no time thereafter did it achieve a state of solvency. The Court finds that the foregoing transfers from the Hail Account of approximately $418,000.00

made by Clarke or his employees at his direction, at a time when USAFORM was insolvent, was a dishonest and fraudulent invasion by Clarke of a trust fund clearly belonging to the pool participants and protected against such loss by Section 5 of the bond. These wrongful acts were willful and flagrant violations of the fiduciary duty that was owed the pool participants. Glens Falls Indemnity Co. v. National Floor and Supply Co. (CCA 5th) 239 F.2d 412, 414; Franklin Savings and Loan Company of Macon v. American Employees Insurance Company (CCA 5th) 99 F.2d 494; Insurance Company of North America v. Greenberg (CCA 10th) 405 Fed. 2d 330; Genesee Wesleyan Seminary v. U. S. F. & G., 247 N. Y. 52, 159 N. E. 720; Duel v. National Surety Corp., 64 S. Supp. 961, affirmed 157 F. 2d 516. In the latter case, Judge Duffy sumed it up when he said at page 966:

> "The plaintiff correctly maintains that failure to remit premiums under the agency contract being established, such failure, aside from all other considerations, constituted acts on the part of Kambe for which the defendant is liable under the bond. Such failure is dishonest action. Citizens Trust & Guaranty Co. v. Globe & Rutgers Fire Insurance Co., 4 Cir., 229 F. 326, Ann. Cas. 1917C, 416; National Surety Co. v. McCutcheon, Tex. Civ. App., 270 S. W. 1062; Fidelity & Deposit Co. of Maryland v. People's Bank of Sanford, 4 Cir., 72 F. 2d 932; American Surety Co. v. Pauly, 170 U. S. 160, 162, 18 S. Ct. 563, 42 L. Ed. 987. Such failure is also fraudulent action. Magee v. Manhattan Life Insurance Co., 92 U. S. 93, 23 L. Ed. 699. In addition such failure is embezzlement. United American Fire Insurance Co. v. American Bonding Co., 146 Wis. 573, 131 N. W. 994, 40 L. R. A., N. S., 661; Aetna Life Insurance Co. v. Mabbett, 18 Wis. 667; Wells v. Collins, 74 Wis. 341, 43 N. W. 160, 5 L. R. A. 531; Black v. Whitewater Commercial & Savings Bank, 188 Wis. 24, 205 N. W. 404; Illinois Surety Co. v. Donaldson, etc., 202 Ala. 183, 79 So. 667."

The Receiver's claim of $311,624.58 has been clearly established.

In the case of Limited, the uncontradicted testimony shows that some six months after the effective date of the bond, its current assets exceeded its current liabilities by $77,000.00. Through the Riggs report, F. & D. attempted to show that Limited was insolvent at the time F. & D.'s bond became effective, the report stating that cash on hand immediately prior to the effective date of the bond was insufficient to pay outstanding reinsurance premium balances due Limited's clients. This contention is clearly controverted by the December 31, 1959, balance sheet of Limited which shows that as of that date, six months after the bond became effective, reinsurance premiums receivable were more than sufficient to pay reinsurance premium balances due clients. Thereafter, Limited's situation steadily deteriorated. Saul Greenfield, a Certified Public Accountant employed by the London underwriters with whom Clarke placed most of his reinsurance business, testified that during the years 1960, 1961, and 1962, transfers in excess of $500,000.00 were made from Limited's premium accounts to other Clarke corporations in violation of Section 125 of the Insurance Law of the State of New York, supra. H. Alexander Stebler, who managed Limited and Pan American under Clarke's direction, testified that while Limited premium receipts were generally deposited into a separate premium account, that account was freely invaded for the purpose of making these large cash transfusions to Clarke's other ventures, and that Limited was insolvent at all times when these transfers were made. The Receiver's claim of $277,308.00 was adequately documented by audit reports received in evidence and unrefuted. The Court finds that the foregoing transfers from Limited's premium account in excess of $500,000.00, made by or upon express

instructions of Clarke at a time when Limited was insolvent, was a dishonest and fraudulent invasion of a trust fund clearly belonging to the underwriters with whom Clarke dealt, and protected against such loss by Section 5 of the bond. The Receiver's claim of $277,308.00 is thereby clearly established.

In the case of Pan American, the testimony parallels that with respect to Limited. The only difference between the two corporations seems to be that Pan American's business originated in Latin America and its volume was substantially less than Limited's. Claimant's Exhibit 7 shows improper transfers from its premium account of $33,666.37 and Claimant's Exhibit 8 shows travel and entertainment expenses of $15,018.24 paid therefrom, for a total unauthorized expenditure of $48,684.61. As these expenditures were made from premiums funds at a time when Pan-American was insolvent, upon the express direction of Clarke, such disbursements from its premium account constitute a dishonest and fraudulent invasion of a trust fund belonging to the underwriters and protected against such loss by Section 5 of the bond. The Receiver's claim of $42,239.21 is thereby clearly established. In the case of both Limited and Pan-American, the uncontradicted evidence is that the claimed losses occurred after the bond came into effect.

Clearly, then, the actions of Clarke and his employees who cooperated with him in thus depleting the premium accounts of these three corporations, constituted "fraudulent and dishonest acts" as those terms are used in the bond. While it is undisputed that Stebler, Grundy and Mrs. Murphy received nothing other than their salaries, it is also a fact that they freely did Clarke's bidding, knowing that what was being done was dishonest. Mr. Grundy and Mrs. Murphy testified that they knew of no other jobs available at the substantial salaries they were receiving

from Clarke, so they continued to the end even though they were worried enough to consult a lawyer concerning the danger to them by reason of their complicity in Clarke's fraudulent schemes.

2. Losses Contemplated by the Bond.

F. & D. contends that as these funds were withdrawn from the premium accounts and applied to "proper corporate purposes", and as all such transactions were properly recorded on the books of account of the various corporate insureds, no "loss" within the coverage and meaning of the bond occurred. This argument, in the light of the facts developed at the trial, is untenable.

In the inter-office communication at page 62 of claimants' Compound Exhibit 1 (specific portions of the Record on Appeal), F. & D. fully discusses the applicability of Section 5 of the bond (supra) to the various situations that later occurred:

> ". . . in our opinion, the funds in the Premium Account, as well as the General Account, are covered against loss through any of the acts covered by our bond caused by employees of our Insured as defined therein. The premiums may belong to the members of the Pool and the profits, if any, are eventually distributed to them. Nevertheless, such funds constitute money 'belonging to the Insured, or in which the Insured has a pecuniary interest, or for which the Insured is legally liable, or held by the Insured in any capacity whether the Insured is legally liable therefor or not.' . . . In either case the funds in the Premium Account would be covered. . . . *If funds in the Premium Account are embezzled by its employees, therefore, we would reimburse our Insured for such funds either as property held by the Insured in any capacity or property as respects which it is legally liable to others, viz., the Pool's participants.* In other words, such property is covered by the bond but not directly in favor of the Pool's participants." (Emphasis added.)

While the letter referred only to the hail pool premium monies, F. & D. concedes that the reinsurance premiums held by Limited and Pan-American are governed by the same principles.

All of the claimed losses were suffered while the fidelity bond was in full force and effect. Although the named insureds were all insolvent at all times when the above described illegal transfers were being made, the case at bar is even stronger than that of Franklin Savings & Loan Company of Macon v. American Employers Insurance Company, supra. Premium funds here were held in a fiduciary capacity as trust funds for the various insurance companies doing business with the named insureds. These various insurance companies have claims totaling \$631,171.79 which have been recognized as valid by the Flagler County Circuit Court as is shown by certified copies of its Orders filed in this cause. If the named insureds are to be indemnified against loss on account of dishonesty of their employees, then F. & D. must pay this amount to them in order for them to respond. This is what F. & D. said it would do, and it is hard to imagine a more fitting example for the application of Section 5 of the bond. As the premium money belonged to others, the language of that section is meaningless if F. & D. can successfully defend on the ground of no loss to the named insured. While the Receivership Orders do establish an economic loss to these insured corporations, by virtue of the express provisions of Section 5 of the bond it is not necessary that there be economic loss to them where there is misappropriation of money they are holding in trust.

3. Clarke — the Alter Ego.

F. & D. argues that the fact that Clarke is the alter-ego of the named insureds eliminates its liability for any loss occasioned by Clarke, citing the companion cases of McKee v. American Casualty Co. (CCA 5th) 316 F. 2d 428 and McKee v. Great American Ins. Co. (CCA 5th) 316 F. 2d 473. However, there are three basic distinctions between the McKee situation and the case at bar. First, in McKee, the sole stockholder took money belonging to his solely owned corporations, thereby causing them to be unable to pay their general creditors. Here, Clarke misappropriated trust money held by his corporations but belonging to the pool participants and the underwriters group; compare Franklin Savings & Loan Co. v. American Employers Ins. Co., supra. Thus Clarke's stock ownership in the named insureds has nothing to do with the matter because the misappropriated money did not belong to the insureds, but to others. Secondly, McKee's corporations were in business for themselves, investing their own funds for their own account. In the case at bar, Clarke's corporations were in the business of managing large sums of money belonging to others and F. & D. knew it (R. 184). Finally, the wording of the bond in McKee read as follows: "Robert A. McKee, dba Industrial Finance Corporation and Commercial Capital Corporation". In the case at bar, the named insureds were the various Clarke corporations. The significance of the wording of the McKee bond was explained by Wade H. Everhardt, Jr., the agent who wrote it. His uncontradicted testimony was that McKee came to him to obtain a bond protecting *himself* against stealing by his employees. Everhardt further testified that since McKee was the sole owner of all the stock, the bond was so written as to protect only McKee's interest:

> ". . . He said that he was interested in protecting himself, because he was the sole owner of all the stock . . . so I suggested that the proper way to write his insurance to protect his interests, which was what we are primarily involved with, was to write the policies in the name of Robert A. McKee, dba Industrial Finance Corporation and/or Commercial Capital Corporation."[2]

The above should be compared with Messinger's testimony that F. & D. intended to protect against theft by Clarke himself as well as by other employees:

> "Q. And you collected a premium based on the fact, of course, that Clarke was one of the covered employees?
>
> A. That is correct. (R. 181)
>
> * * *
>
> Q. So what you were trying to insure was the named insureds, corporations all, against thievery by any employee, including Clarke?

Robert A. McKee was the insured, F. Wylly Clarke was a covered employee, and there is quite a difference. There is also a very substantial difference where those who suffer the ultimate loss, as in McKee, are the general creditors of the corporation as against the situation at hand where they are cestui que trustent. The rationale of McKee is this: the only thing that an alter ego stockholder could steal is money that does not belong to his wholly owned companies, as a man cannot steal from himself. Here, Clarke stole the only thing that he could steal — money that his wholly owned corporation held in trust for others.

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[2] Page 42 of the printed record on appeal to Fifth Circuit Court of Appeals in *McKee* v. *Great American Ins. Co.*

There is yet another reason why this defense is unavailing, to be gleaned from the admissions of Messinger, who testified after the so-called "Rossiter Reports" and the "Riggs Report" were made to F. & D. He said that at the time it wrote the bond F. & D. knew everything about Clarke's operation, including his stock ownership and the fact that he would be managing large sums of money belonging to others; that Clark controlled the named insured corporations and that he was the only one in position to misappropriate a substantial sum of money. (Obviously, that would be premium money.) Messinger stated that Clarke himself was a covered employee even though he was the sole stockholder and alter ego of the named insureds. He admitted this was unusual but F. & D. had "perfect experience" with Clarke's operation in the past and wanted his business. Perhaps F. & D., relying on its prior "perfect experience", felt the hazard was lessened because Clarke, "the sole stockholder and alter ego" was in control and, as the owner, he was vitally interested in the success of the named insured corporations. Regardless of its motive, F. & D. included Clarke as a covered employee and collected a premium for furnishing protection against misappropriation or dishonesty by him, with full knowledge of the entire operation.

While all of the facts were not before the Fifth Circuit Court of Appeals when this matter was before it, that Court did conclude that the mere fact that Clarke may be the alter ego of the insured corporations does not eliminate F. & D.'s liability. Developments at the trial strengthen the validity of that conclusion.

4. Officers — Knowledge and Collusion.

F. & D. next contends that because the acts complained of were all done openly and were spread on the books of

the various Clarke corporations, other "officers" of these corporations knew of these acts, thus causing coverage to be cancelled as to Clarke by the bringing into play of the "knowledge and discovery" provisions of Sections 6, 7 and 12 of the bond, supra. However, F. & D. knew when it wrote the bond that in the event of fraud by Clarke, there was no one to whom it could look or upon whom it could rely to give notice of such misconduct. F. & D. also knew that the only person who could steal anything of consequence was Clarke, and further knew that the only thing he could steal was the very substantial amount of premium deposits entrusted to the care of his corporations. By the very nature of the situation, with which F. & D. was fully aware, Clarke was the alter ego of these corporations and therefore, by definition, the only person in authority. For the purposes of this suit, Sections 6, 7 and 12 of the bond are substantially the same. They invalidate coverage as to any employee from the time that his dishonesty is discovered by an officer not in collusion with him. Clarke was, in addition to being the "sole stockholder and alter ego" of the named insureds, a covered employee under the bond. Mr. Barnett was asked why these sections spoke in terms of "officer" or "partner" and he replied that knowledge had to come to someone "in authority" before the cancellation became effective:

> "A. The reason for that is this, that a clerk if it did not specify someone in authority, some clerk might obtain that information and it would not be fair to the insured to claim or to have their liability terminated by reason of somone in a menial position knowing of dishonesty. It's to protect the corporation." (R. 213)

Thus, F. & D. did not contemplate the application of these cancellation clauses to a menial even though bearing a title. It is obvious that there were, as to theft by Clarke,

no individuals "in authority" to whom the knowledge and discovery sections could apply. F. & D., well knowing Clarke's dominant position, elected to insure against *his* theft. The Fifth Circuit Court of Appeals in its Opinion observed:

> "F. Wylly Clarke . . . controlled each corporation."

and the trial as certainly underlined this observation.

Since F. & D. knew Clarke was the sole stockholder and alter ego of the named insureds, it would seem that F. & D. waived the knowledge and discovery provisions of their bond insofar as Clarke himself was concerned. This follows as a natural consequence. However, it is not necessary to decide this point because the testimony at the trial satisfies this Court that except for Clarke, there were no real officers of these corporations as that term is understood. He was the Alpha and Omega of the named insured corporations. His employees who held various titles, and thus were officers in name only, exercised no authority but simply did Clarke's bidding. He set the policies, he issued the orders, he made the decisions. He would brook no disagreements. While his subordinates grumbled among themselves about his actions, there was no open revolt because it was apparent that it was either "vote aye or resign". He would squelch any dissent by reminding his "officers" that he was the boss—that these were his companies—and that he would decide how the money would be spent. This Court finds that under the evidence and testimony presented, Clarke was the only officer of the named insureds as that term is used in the bond. It follows that the cancellation provisions of the bond did not apply.

However, even if there were officers other than Clarke, the cancellation provisions would not take effect. The only other "officers" that were proven to know of Clarke's misappropriation and dishonesty were Grundy, Stebler and Murphy, who were by their own testimony proven to be in collusion with him. In U. S. F. & G. v. Walker, (CCA 5th) 248 Fed. 42, 44, the Court dealt with a provision similar in import to Sections 6, 7 and 12. The Court observed:

> "Nor are those provisions to be regarded as contemplating the giving of notice when the only representatives of the bank who were apprised of the cashier's guilt of larceny or embezzlement participated in or connived at his crime. Fidelity and Deposit Ins. Co. v. Courtney, 186 U. S. 342, 361, 22 Sup. Ct., 833, 46 L. Ed. 1193."

In dealing with a knowledge and discovery bond provision that was identical to Section 12 of F. & D.'s bond, Judge Duffy, in Duel v. National Surety, supra, said at page 967:

> This provision has no application. No cancellation was effected thereby because, as the evidence shows, every other officer and employee of the insurance company, with respect to Kambe's acts, was in collusion with him."

F. & D. takes the position that because the transactions were spread upon the books, all officers had to know of Clarke's dishonest acts. This may, but does not necessarily, follow. Stebler testified that the books of Limited and Pan-American could be seen only by officers of the companies, but did not state that any other officers actually saw them. Grundy and Murphy testified that they never looked at the books. Because of the nature of their jobs, they knew what was going on. It is fair to speculate that other so-called officers may have known what was happening, but this does not eliminate the need for F. & D. to prove actual knowledge of Clarke's dishonesty, and this F. & D. has not done. It is just as reasonable to assume that those who may have had

such knowledge were also willing participants in the over-all Clarke scheme and also kept their silence in order to continue on the payroll. In a somewhat similar bond suit, Insurance Company of North America v. Greenberg (CCA 10th) 405 F. 2d 330, the Court observed:

> "Although the classic loss under such a provision may well be an employee embezzlement for direct personal benefit we can read no such limitation into this bond. Surely the obtaining of appellee's money through fictitious assignments and the conversion of trust monies paid upon valid accounts, constituted both fraud and dishonesty. And the money so obtained, after commingling with Oklahoma Steel's own money, indirectly reached the errant employees through payment of their corporate salaries."

While seemingly beyond the scope of the stipulated issues, F. & D. attempted to fashion a defense based upon its assertion that the bond never became effective as to Clarke because, it alleges, he was engaged in a course of dishonesty prior to June 29, 1959, the effective date of the bond. There are numerous factual as well as legal and logical flaws in this argument. In the first place, F. & D. attempted to prove this by the report of George Riggs. However, it became obvious at the trial that Mr. Riggs apparently did not understand the complexities of Clarke's operations, as has been noted above, or simply did not have all the facts, so that any evidence from him on this subject is of doubtful probative value. Any inference of prior dishonesty to be drawn from the Riggs report was wholly negated by the subsequent testimony of Barnett, given on deposition in February of 1966, nearly one year later:

> "A. . . . in the first place, let me say we have not seen what we consider any evidence of dishonesty . . . (R. 202)

> "Q. Now, then, it is your opinion that Mr. Clarke was guilty of misappropriation prior to June 29, 1959?
>
> "A. No, we don't know of any dishonesty on Mr. Clarke's part . . . (R. 212)
>
> "We have seen no proof of it, of dishonesty." (R. 212)

The pre-trial stipulation as to the facts with reference to bond coverage, entered into by the parties some four years after the Riggs report, stated:

> "That at all times material to this suit, said bond was in full force and effect. The employees covered under the bond specifically included by name and position, in addition to others: F. Wylly Clarke, Jr., sole stockholder . . ."

They also stipulated as issues of law on which there was agreement:

> "(b) Clarke was a covered employee under the bond.
>
> (c) The bond was in full force and effect at all times material to this suit."

Such stipulations are wholly inconsistent with its position that Clarke was never covered. If, in fact, F. & D. ever had such a defense, these repeated stipulations surely constituted a waiver thereof. Even if F. & D. had not waived its attempted defense of prior dishonesty, this would raise serious questions under paragraph C of the General Agreements of the bond relating to F. & D.'s obligation to pick up losses occurring during coverage of the prior bond if discovered during the term of this bond. Messinger testified that F. & D. had bond coverage on Clarke's corporations from 1949 to 1956, which was then replaced by Lloyds until F. & D. recaptured the business in 1959. As interesting as these questions are, they need not be explored here.

It has become obvious to the Court that F. & D. has not known from the start of this matter to this point just what position it should take with respect to its coverage defenses. It is equally obvious that the printed form of bond issued by F. & D. simply does not fit the unusual circumstances of this case. F. & D., knowing of these anomalies and knowing that issuance of such a bond in a situation such as this was most unusual, walked into this loss with its eyes wide open. In its complaint in paragraphs 12 and 14 thereof, F. & D. alleged that the entire bond was void ab initio. This position was confirmed by the F. & D. inter-office communication from A. K. Bennett to P. C. Symonds appearing at page 89 of the record exhibit. Barnett stated at the trial, however, that F. & D. had never taken the position that the bond had never become effective and inferred that Mr. Bennett didn't know what he was talking about. However, Messinger confirmed that F. & D.'s home office did, indeed, take that position. As Mr. Barnett was F. & D.'s claims attorney who appears throughout the record to have been in charge of this case from the start, the Court must assume that he also knew of the aforesaid allegations of paragraphs 12 and 14 of the complaint, which are binding upon F. & D.

Either the bond was effective or it was void, and F. & D. is found on both sides of this issue. It has alleged one way, stipulated the other, and testified both ways. This Court concludes that the bond was effective when issued. Either Clarke was covered or he was not, and F. & D. is also found on both sides of this issue. This Court concludes that Clarke was covered by the bond.

Although F. & D. was given the right to raise all of these varied defenses over the strenuous and well-reasoned objections of the claimants based upon F. & D.'s failure to return any portion of the premiums it charged for the bond

or for affording coverage of Clarke, F. & D. has wholly failed to establish any of them.

5. Bond Coverage.

As noted above, coverage of the bond was $100,000.00 as to each of the insureds' employees involved in the covered losses plus $400,000.00 of excess coverage. As Claimants have established the direct involvement in these established losses of four such employees, the coverage thus available to the Claimants is $800,000.00. Interest, costs and attorneys' fees would not be limited by this amount.

6. Interest.

Under the provision of the bond, no action lies against F. & D. until ninety days after the filing of proofs of loss. As F. & D. filed its complaint for a declaratory judgment before expiration of that time period wherein it denied all liability to the claimants this action matured the claimants' rights, and interest on the established claims shall be computed from August 30, 1963, to the date of the entry of final judgment. F. & D. makes some contention that no interest should be allowed during the period of time consumed by the appeal, but this contention cannot be sustained.

Judgments in the amount of $311,624.58 in favor of Barbara B. Murphy as Receiver for Usaform Hail Pool, Inc.; $277,308.43 in favor of Barbara B. Murphy as Receiver for U.S. & Foreign Management, Ltd.; and $42,239.21 in favor of Usaform Pan-American, Ltd.; together with interest, and costs as hereinafter determined, will be entered upon submission of proof respecting costs.

s/ CHARLES R. SCOTT
Judge

Dated: September 25, 1970

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-Civ-J-S

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,
Plaintiff,

v.

USAFORM HAIL POOL, INC., et al.
Defendants.

FINAL JUDGMENT

This Cause coming on for hearing on all undisposed of matters, and it appearing that this cause was tried before the undersigned District Judge on August 3, 4, and 5, 1970 and the Court having filed its opinion containing findings of fact, conclusions of law, and order for judgment, and the court being fully advised,

It Is Hereby Ordered and Adjudged:

1. That Barbara B. Murphy as Receiver for Usaform Hail Pool, Inc. have judgment against the plaintiff, Fidelity and Deposit Company of Maryland, in the sum of Three Hundred and Eleven Thousand, Six Hundred and Twenty-four Dollars and Fifty-eight Cents ($311,624.58) together with interest thereon at the rate of 6% per annum from August 30, 1963 to the date of this judgment in the amount of One Hundred Thirty-two Thousand, Two Hundred and Fourteen Dollars and Nineteen Cents ($132,214.19) making a total of Four Hundred Forty-three Thousand, Eight Hundred and Thirty-eight Dollars and Seventy-seven Cents ($443,838.77) to date hereof.

2. That Barbara B. Murphy as Receiver for U.S. & Foreign Management, Limited, have judgment against the plaintiff, Fidelity and Deposit Company of Maryland, in the sum of Two Hundred and Seventy-seven Thousand, Three Hundred and Eight Dollars and Forty-three Cents ($277,308.43), together with interest thereon at the rate of 6% per annum from August 30, 1963 to the date of this judgment in the amount of One Hundred Seventeen Thousand, Six Hundred and Fifty-four Dollars and Seventy-five Cents ($117,654.75) making a total of Three Hundred Ninety-four Thousand, Nine Hundred and Sixty-three Dollars and Eighteen Cents ($394,963.18) to date hereof.

3. That Defendant, Usaform Pan-American Limited have judgment against the plaintiff, Fidelity & Deposit Company of Maryland in the sum of Forty-two Thousand, Two Hundred Thirty-nine Dollars and Twenty-one Cents ($42,239.21) together with interest thereon at the rate of 6% per annum from August 30, 1963 to the date of this judgment in the sum of Seventeen Thousand, Nine Hundred and Eight Dollars and Twenty-seven Cents ($17,908.27), making a total of Sixty Thousand, One Hundred and Seventeen Dollars and Forty-eight Cents ($60,117.48) to date hereof.

4. That Barbara B. Murphy as Receiver for Usaform Hail Pool, Inc. and U.S. & Foreign Management Limited have judgment against plaintiff for costs herein taxed at $354.00 Dollars.

5. Let execution issue for all the sums hereinabove set forth.

Done and Ordered in Chambers at Jacksonville, Duval County, Florida, this the 25th day of September, A. D. 1970.

CHARLES R. SCOTT
District Judge

APPENDIX G

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 24385

AMERICAN EMPIRE INSURANCE COMPANY
OF SOUTH DAKOTA, ET AL,
Appellants,

VERSUS

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,
Appellee.

Appeal from the United States District Court for the Middle District of Florida

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(March 6, 1969)

Before JONES, WISDOM and DYER, Circuit Judges.

DYER, Circuit Judge: Fidelity and Deposit (F & D) sought a declaratory judgment to have its liability determined on a fidelity bond issued by it to certain named insureds as defendants. To avoid a multiplicity of suits in various courts, it was stipulated that certain parties claiming to have interests protected by the bond be permitted to intervene.[1] The District Court rendered sum-

[1] The defendants named in the complaint (and who were named as insureds in the fidelity bond issued by F & D) were: USA-FORM Pan-American, Ltd. (Pan-American); USAFORM Hail Pool, Inc. (Hail Pool); U.S. & Foreign Management, Inc. and

mary judgment against the intervenors on their claims and counterclaims, holding that they were neither named insureds in, nor third party beneficiaries of the bond. This appeal followed. We affirm.

The facts are undisputed. The fidelity bond issued by F & D provided for the indemnification of the four corporate named insureds for any losses caused by "fraudulent or dishonest" acts of their employees. The defendant corporations operated as brokers or clearinghouses for insurance companies but sold no insurance of their own. Hail Pool managed a pool created by certain insurance companies to cover hail damage to crops owned by farmers who were insureds of these companies. Hail Pool collected the premiums for these companies and paid any losses suffered by the companies' insureds. At the end of the year any excess was remitted to the participants of the pool. Foreign Management and Pan American acted as intermediaries between insurance companies and reinsurance companies. They transmitted reinsurance premiums from the reinsured company to the reinsurer and remitted return premiums from the reinsurer to the reinsured. The named insureds had the following in common: F. Wylly Clarke was the Chief executive officer and controlled each corporation; each corporation was a named insured in the fidelity bond issued by F & D; each corporation was in possession of premium monies belonging to

U.S. & Foreign Management, Ltd. (Foreign Management); and Barbara B. Murphy, as Receiver for the latter three corporations. The intervenors (who were not named in the bond) were: American Empire Insurance Company of South Dakota, on behalf of itself and all other insurance companies who were shareholders in the USAFORM Hail Pool; Stuyvesant Insurance Company, on behalf of itself and all other insurance companies who employed U.S. & Foreign Management, Ltd., and USAFORM Pan-American Ltd.

insurance companies; and each corporation was found to have substantial shortages in its premium accounts.[2]

The claims made on the bond by the named insureds attributed the shortages to the dishonesty of Clarke acting alone and/or in collusion with others. F & D disclaimed liability under the bond. The plaintiff and the defendants stipulated that American Empire Insurance Company could intervene as the class representative for the Pool Participants who were claiming loss of their premium monies held by Hail Pool and that Stuyvesant Insurance Company could intervene as the class representative for the underwriters who were claiming loss of reinsurance premiums and return premiums entrusted to Foreign Management and Pan American. In addition to seeking recovery on the bond the intervenors counterclaimed for punitive damages, alleging that F & D fraudulently refused to acknowledge its liability under the bond to the named insureds. The District Court granted a partial summary judgment finding that ". . . there is no genuine issue as to any material fact that would sustain the right of any one of the intervenors . . . to recover under the bond . . . either as a named insured or as a third party beneficiary protected by the bond . . ." The District Court likewise denied the intervenor's counterclaim for punitive damages.

[2] On February 18, 1963, Hail Pool was placed in receivership by order of the Seventh Judicial Circuit Court, Flagler County, Florida. An audit of the books of Hail Pool disclosed a shortage of premium monies belonging to pool participants in the amount of $311,624.58. The same court placed Foreign Management in receivership on the same date. An audit of the books of Foreign Management disclosed a shortage of $277,308.43 in premium monies belonging to insurance companies doing business with it. An audit of the books of Pan American disclosed a shortage of premium money deposits in the amount of $42,239.21.

The sole issue to be resolved in this appeal is whether or not the intervenors are third party beneficiaries of the bond, as they insist. To support this, intervenors urge that it was the underwriting intent of F & D that the intervenors were to be beneficiaries of the bond. This must be concluded, the intervenors say, because of (1) the probable lack of liability of F & D to the named insureds; (2) correspondence exchanged between F & D and the named insureds' president Clarke, and (3) the terms of the bond itself.

Intervenors' attempt to prognosticate the outcome of a trial on the merits of F & D's liability to the named insureds in the bond gives us little pause. F & D's liability or non-liability has not been decided by the District Court and is not now before this Court. Whether the underwriter may or may not have a defense against its named insureds is not relevant in considering F & D's liability to the Pool Participants as third party beneficiaries of the bond.

The exchange of correspondence between Clarke and F & D, the intervenors argue, furnishes evidence of the underwriting intent to protect the intervenors. On January 16, 1962, Clarke wrote F & D as follows:

> In setting up USAFORM Hail Pool, Inc. we will maintain two bank accounts; one a premium account, and the other a general account. Management fees and over-writing commissions will be deducted from premiums and put in the general account which belongs solely to Hail Pool. The premium account belongs to the Pool Companies; however, from this account will be paid losses and loss adjustment expenses incurred, and recognized Pool expenses.
>
> Several of the Pool Companies have approached us and asked if our fidelity bond could be extended to protect them in case of loss in the premium account due to dishonesty of Hail Pool's employees. I am wondering if this is not now covered under the bond as follows:
>
> "Ownership of Money or Other Property
>
> "Section 5. The Insured property may be owned by the Insured or held by the Insured in any capacity whether or not the Insured is liable for the loss thereof, or may be property as respects which the Insured is legally liable."
>
> I really don't know how to interpret the above unless the Pool participants were named as assureds under the bond. Would this be possible? If they are not named, does our bond protect the companies against loss on the funds in the premium account?

In reply, the Vice President of F & D wrote Clarke:

> I have discussed with Mr. Henderson and our executives at our Home Office, your question as to the extent of cover of the "Ownership of Money or Other Property Clause" as appearing in the bond. It is our opinion that the funds in the "Premium Account" are covered against loss through any of the acts covered by our bond caused by employees of our USAFORM as defined therein.
>
> The premiums in the "Premium Account", although they may belong to the Pool members, constitute money "belonging to USAFORM", or in which Hail Pool has a pecuniary interest, or for which the corporate entity is legally liable, or held by the Corp., in any capacity whether legally liable therefor or not.
>
> We cannot extend the bond to the Pool's participants since they do not qualify as "joint insureds". Our liability is confined to USAFORM Hail Pool, Inc., and we cover only the losses which it may sustain through acts covered by the bond. If funds in the "Premium Account" are embezzled by the employees of Hail Pool, therefore, we would reimburse the Corp. for such funds

> either as property held by USAFORM in any capacity as respects which it is legally liable to others, viz, the Pool's participants. In other words such property is covered by the bond but not directly in favor of the Pool's participants.
>
> The Pool's participants are not eligible to be Joint Insureds under the bond under our rules because to include them as such would make the bond liable for the acts of their employees, in addition to the acts of USAFORMS employees.
>
> We believe the above interpretation should satisfy the Pool's participants as to a possible loss in the "premium account" due to dishonesty of Hail Pool's employees.

Thereafter Clarke wrote one of the Pool Participants:

> While we cannot arrange with Fidelity and Deposit to extend coverage to the pool companies as "joint insureds", it is true that we are covered against losses which may be sustained through acts covered by the Commercial Blanket Bond. This, in turn, means that the pool companies would be protected.

If the correspondence may be considered as evidence of underwriting intent, about which we have grave doubts because the bond's language is clear and unambiguous, we read the letters to say no more than that the Pool Participants could be indirectly benefited by the bond since an *insured* loss of the Premium Account funds would be covered and Hail Pool would then be paid under the terms of the bond. To include the Pool Participants within the coverage of the bond would result in the inclusion of their employees. It is obvious that such was not the intent of the parties.

Going one step further the intervenors argue that the correspondence is not just evidence of underwriting intent, it is a constituent part of the bond. This is both novel and unsound. There was no correspondence by F & D with the Pool Participants. The Pool Participants were never named as additional insureds. F & D refused to name any of them in its fidelity bond. None of the Pool Participants paid any premium to F & D for protection under the bond or applied to F & D directly for fidelity insurance on the Pool operations. *Buxton* v. *International Indemnity Company,* 1920, 47 Cal. App. 583, 191 P. 84, and *Aetna Insurance Company* v. *Eisenberg,* 8 Cir. 1961, 294 F.2d 301, relied on by intervenors are inapposite. In *Buxton* the court held that a letter agreement preceding the issuance of a policy, that the policy would cover certain risks, became a part of the insurance contract subsequently issued. Here F & D never recognized the right of any Pool Participant, nor did F & D ever send a letter to a Pool Participant giving any interpretation of the bond, or indicating that its coverage extended to anyone other than the named insureds. In *Eisenberg* the contract specifically gave the customers of the insured the right to sue.

Pointing to Section 5 of the conditions and limitations of the bond, "The insured's property may be owned by the insured, or held by the insured in any capacity whether or not the insured is liable for the loss thereof, or may be property as respects which the insured is legally liable," the intervenors urge that this protects third parties whether the named insureds are legally liable or not and where the contracting parties intend to confer a benefit on a third party, the third party has a direct action to enforce it. It is true that any losses suffered by the named insureds, whether or not the insureds were liable for the loss thereof, are covered. This would cover losses of funds held by a named insured which it may or may not owe to the Pool

Participants. Legal liability of the named insured to a third party does not however create a legal liability of F & D to third parties under the bond. The claims of the third party Pool Participants are not against F & D but against the named insureds or their Receiver for failure to account to the Pool Participants. Since contracting parties are presumed to act for themselves, such an intent to benefit should be clearly expressed in the contract. In *American Surety Co. of New York* v. *Smith,* Fla. 1930, 100 Fla. 1012, 130 So. 440, Judge Strum, then a Justice of the Supreme Court of Florida and later a judge of this Court, stated:

> Where, therefore, it is manifest from the nature or terms of a contract that the formal parties thereto intended its provisions to be for the benefit of a third party, as well as for the benefit of the formal parties themselves, the benefit to such third party being the direct and primary object of the contract, or amongst such objects, such third party may maintain an action on the contract even though he be a stranger to the consideration.

Id. at 441.

It would seem that it is not manifest from the nature of a fidelity bond that uninsured parties should be allowed to recover. Rather, in the case *sub judice,* Judge Strum's further comment is more apropos:

> When a contract is designed solely for the benefit of the formal parties thereto, third persons cannot maintain an action thereon, even though such third persons might derive some incidental or consequential benefit from its enforcement. *Leon* v. *Kerrison,* 47 Fla. 178, 36 So. 173; *Wright* v. *Terry,* 23 Fla. 160, 2 So. 6.

Id. at 441. *See also* 7 Fla. Juris. 169, Contracts Section 101; *First National Bank of St. Augustine, et al.* v. *Perkins,*

Fla. 1921, 81 Fla. 341, 87 So. 912; *Punta Gorda Bank* v. *State Bank of Ft. Meade,* Fla. 1907, 52 Fla. 399, 42 So. 846.

In an effort to put a more equitable gloss on the Pool Participants as third party beneficiaries the intervenors take the position that if the bond was not written for their benefit there is no reason for the bond because Clarke was the alter-ego of the defendant corporations and his dishonesty forecloses any liability of F & D. Clarke, however, was only one of the employees covered by the bond. Moreover, F & D denied liability because other officers of Hail Pool knew of Clarke's dishonesty. The mere fact that Clarke may be the alter-ego of the defendant corporations does not eliminate F & D's liability. There is no doubt that Clarke was covered by the bond.

Intervenors rely upon property insurance, warehousemen's liability, and bailor-bailee cases in an attempt to analogize them with their asserted third party beneficiary claims here. But a distinction must be drawn between indemnity and property insurance. The fidelity bond was an indemnity insurance contract. The insurer's liability does not arise until the insured has suffered a proven loss. It is in the nature of a personal insurance contract. The insurance is not on property but is for loss of property. This distinguishes *Globe and Rutgers Fire Ins. Co., et al.* v. *U.S.,* 5 Cir. 1953, 202 F.2d 696, urged upon us by the intervenors, which involved a policy insuring property against loss by fire. Hail Pool's policy insured only losses resulting from a breach of duty by an employee.

The distinction between insurance on property and on loss of property also applies to the warehousemen cases and the bailee cases. Moreover, in *Aetna Insurance Co.* v. *Eisenberg, supra,* relied on by intervenors, where the insurer has issued a furrier's customer basic policy, the

contract gave the customers the right to sue. *United States Fidelity and Guaranty Co.* v. *Slifkin,* N.D. Ala. 1961, 200 F. Supp. 563 involved coverage by consigned jewelry which was stolen from the bailee. The contract had an "in-trust-and-on-commission" clause which is common in bailee insurance contracts and under which bailors generally are allowed to sue under a third party beneficiary statute. But here again, this clause is interpreted to insure a bailor's insurable interest in property, and this is so irrespective of the bailee's legal liability for loss.

Finally, intervenors' reliance on *New Amsterdam Casualty* v. *Felder,* 5 Cir. 1954, 214 F.2d 825, is misplaced. The court there simply held that a named insured was not prevented from suing even though he was not the first named insured in the policy.

We are of the firm view that F & D's contract meant just exactly what it clearly said, that is, that it insured the named corporations and those corporations only, against the defalcations of their employees. We can find no support for the intervenors' contention that the District Court should re-write the contract. The rule was succinctly stated in *Hawkeye-Security Ins. Co.* v. *Meyers,* 7 Cir. 1954, 210 F.2d 890, 893, and was adopted by us in *Greyhound Corp.* v. *Excess Insurance Company of America,* 5 Cir. 1956, 233 F.2d 630:

> . . . the insurance policy is the contract between the parties and that the provisions of that contract, which are clear and unambiguous and which are neither illegal by statute nor by reason of their being against public policy, should be enforced by the courts. The courts may not re-write for the parties insurance contracts which are clear and unambigous.

Summary final judgment against the intervenors was properly entered by the District Court. We therefore do not reach the question of punitive damages sought by the intervenors against F & D.

AFFIRMED.

WISDOM, Circuit Judge, dissenting.

I respectfully dissent.

F & D denied liability on the bond on the stated ground that "F. Wylly Clarke, Jr. was never covered". In the complaint F & D alleged that Clarke was "the sole stockholder and alter-ego of each of the assured"; that his fraud was therefore attributable to the assureds. This position, basic to the complaint, rendered the bond worthless to the persons for whom it was primarily issued — the owners of the premium money in the pool.

The law of contracts is not so encrusted with form that we cannot, in this case, cut through the shell of a two-party contract and give effect to the three-party arrangement all of the parties understood and on which the third party beneficiaries, to their detriment, relied. We do not have to prostrate ourselves before Clear and Unambiguous Words when in their natural setting the words mean something more than they say.

The Court's error lies in its assumption that the intervenors' case depends on showing "that it was *the underwriting intent of F & D* that the intervenors were to be beneficiaries of the bond". This is not a case involving only the formal contracting parties where the Court's task is to determine the parties' expressed intention. When third parties rely on a bond, and the bond is primarily for the

protection of the third parties, a court is not justified in looking only to the underwriting intent of insurer. As Williston points out in discussing contracts for the benefit of a third person, "There is no requirement of a mutual intent, as to right of enforcement, on the part of the contracting parties; instead, it is the intent or purpose of the promisee who pays for the promise that has generally been looked upon as governing". 2 Williston on Contracts § 356. See also 4 Corbin on Contracts §§ 774, 770C and Restatement of Contracts § 133(b), 136(1)(a).

Here the promisee was Clarke (through his corporations). Although a purpose of the bond may have been to protect his companies from the defalcations of other employees, there is no doubt that the primary purpose was to protect the Pool Participants to whom the premium money belonged. As Messinger, head of F & D's Underwriting Department testified, a severe loss could result only from Clarke's defalcation. Business obligations to the Pool Participants compelled him to take out the bond to insure his own fidelity. He, of course, knew that the intervenors were relying on the bond for protection of the pool. The correspondence shows that F & D was fully aware of all the facts and of the intervenors' reliance on the bond. No one contends that the Pool Participants were Join Insureds (for their employees would then be covered). The contention is that the object of the bond was to protect the Pool Participants; performance of the bond would satisfy the promisee's obligation to pay the Pool Participants; the insurer received premiums to perform its promise. The Pool was in the nature of a trust fund beneficial title to which was in the participants.

I would analogize Clarke to a bailee. He was in the business of holding premium money for others and managing it as a pool. If Clarke's companies had been in the business of storing furs, and if the furs had been destroyed by fire, the bailors could have maintained a direct action against the bailee's insurer. *Aetna Insurance Co.* v. *Eisenberg,* 8 Cir. 1961, 294 F.2d 301. If Clarke had been holding rolls of paper rejected after delivery and cancellation of the purchase order, the owner of paper would have taken the place of the insured and recovered on a fire loss. *Exton & Co.* v. *Home Fire and Marine Insurance Co.,* 1928, 249 N.Y. 258, 164 N.E. 43. If the insureds here had been storing for others distilled spirits, the owners could have sued the insurer for the value of the spirits destroyed by fire. *Lewis* v. *Home Insurance Co.,* 199 App. Div. 556, 192 N.Y. Supp. 170.

In *United States Fidelity & Guaranty Company* v. *Slifkin,* N.D. Ala. 1961, 200 Fed. Supp. 653, the pertinent policy clause was similar to Section 5 of the F & D bond: "The money, securities and other insured property (except the premises) may be owned by the Insured or held by him in any capacity whether or not the Insured is liable for the loss thereof." The court, in construing this clause, stated:

> Generally, such a clause is held to insure the bailor's insurable interest under a third party beneficiary theory, it being necessary only that there be an expression in the bailee's policy of an intent to insure the bailor's interest. * * * The express language of this clause gives to the bailor a right to be indemnified under the bailee's policy irrespective of the bailee's legal liability for the loss. . . . Elsewhere, moreover, it has been held that the bailor may maintain independently an action against the bailee's insurer in such a case, even where the bailee had deliberately omitted the bailor's claim from proofs of loss. B. N. Exton & Co. v. Home Fire & Marine Insurance Co., 249 N.Y.

> 258, 164 N.E. 43. (1928). See Stillwell Frozen Foods Inc. v. North British & Mercantile Ins. Co., 184 Fed. Supp. 629 (W.D. Ark., 1960); Globe & Rutgers Fire Insurance Co. v. United States, supra. In Alabama, the general principle has been applied in other contexts: 'A third party beneficiary's right to bring an action directly against the obligor for enforcement of his rights under a contract to which he was not a party has been upheld repeatedly.

In *Globe & Rutgers Fire Insurance Co.* v. *United States*, 5 Cir. 1953, 202 F.2d 696, the United States brought suit against six insurance companies for loss by fire of cotton seed belonging to the Commodity Credit Corporation in the custody of a cotton gin company, the named insured. Each of the insurance policies provided: "* * * this policy shall also cover property sold but not delivered, held in trust or on consignment or for storage." This Court held that the United States was protected by the policy provision and could bring a direct action against the insurers.

The Court seeks to distinguish the *Globe & Rutgers* case on the basis of the conceptual difference between insurance against fire losses and insurances against losses due to employee dishonesty. The insurer in the latter instance, it says, acts as an indemnitor and becomes liable only after the insurance has suffered a "proven loss". At this stage of the litigation, of course, losses due to Clarke's dishonesty must be taken as "proven". Beyond that, whether the insurance is called "property" or "indemnity" should not matter. The only distinction between the *Globe & Rutgers* situation and ours is that the cause of the loss there was natural rather than human. I am unable to understand how the Court finds that difference meaningful.

In all of these cases and many others that might be cited the third party is treated as if he were the bene-

ficiary of a fiduciary relationship or the real party at interest. This is because the basic contract is for the benefit of the third party. Here, as to Clarke's misappropriations, the bond would have been meaningless — unless the parties had intended to protect the Pool Participants against Clarke's own defalcation.

APPENDIX H

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

No. 63-186-CIVIL-J

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND
Plaintiff,

v.

USAFORM HAIL POOL, INC., et al,
Defendants,

AMERICAN EMPIRE INSURANCE COMPANY
OF SOUTH DAKOTA, et al,
Intervenor-Defendants.

FINAL SUMMARY JUDGMENT

The above entitled cause came on before the Court on the Motion for Summary Judgment by the plaintiff, Fidelity and Deposit Company of Maryland.

Harry T. Gray of the firm of Marks, Gray, Yates, Conroy & Gibbs appeared on behalf of the plaintiff. W. Warren Cole, Jr. and David K. Sigerson of the firm of Black, Cobb, Cole & Crotty appeared on behalf of all of the defendants and all of the intervenor defendants, above named, in the title of the cause. The Motion for Summary Judgment by Fidelity and Deposit sought such summary judgment as a matter of law against each of the counterclaimants insofar as each claimed punitive damages against the Fidelity and Deposit and a summary judgment as a matter of law against each of the counterclaimants who were not named

as insureds in the bond issued by it (a copy attached to the complaint as Exhibit "A") but asserted claims against the Fidelity and Deposit under said bond as entitled to recover thereunder and claims against the Fidelity and Deposit as third party beneficiaries for whom it was asserted said bond was issued to protect.

As to USAFORM Pan-American, Ltd. it was stipulated that it is a named insured under the bond, Exhibit "A", and its status in the cause is that of a defendant.

The Court finds that the pleadings, depositions and affidavits on file show that there is no genuine issue as to any material fact that in law would permit the recovery of punitive damages under any one of the counterclaim counts against the Fidelity and Deposit Company and that it, as the plaintiff, is entitled to judgment as a matter of law insofar as each of said counterclaim counts seeks to recover punitive damages from the Fidelity and Deposit Company.

The Court further finds from the pleadings, depositions and affidavits on file that there is no genuine issue as to any material fact that would sustain the right of any one of the intervenors, American Empire Insurance Company of South Dakota, Stuyvesant Insurance Company or the underwriters or pool participants, that by intervention they are stipulated to represent, to recover under the bond, Exhibit "A", either as a named insured or as a third party beneficiary protected by the bond, although not named therein as an insured.

The Court further finds that the plaintiff, Fidelity and Deposit Company of Maryland is entitled to a Summary Judgment as a matter of law and it is, therefore,

ORDERED, ADJUDGED and DECREED that the plaintiff's Motion for Summary Judgment be and the same hereby is granted and that the counterclaimant, American

Empire Insurance Company of South Dakota as intervenor have and recover nothing by its claim asserted in the Count I of the counterclaim and that the plaintiff as of said Count and said intervenor, go hence without day.

The Court further finds that the plaintiff, Fidelity and Deposit Company of Maryland is entitled to a Summary Judgment as a matter of law and it is, therefore,

ORDERED, ADJUDGED and DECREED that the plaintiff's Motion for Summary Judgment be and the same hereby is granted and that the counterclaimant, American Empire Insurance Company of South Dakota, acting on behalf of pool participants, have and recover nothing by its claim asserted in the Count III of the counterclaim and that the plaintiff as to said Count and said intervenor, go hence without day.

The Court further finds that the plaintiff, Fidelity and Deposit Company of Maryland is entitled to a Summary Judgment as a matter of law and it is, further

ORDERED, ADJUDGED and DECREED that the plaintiff's Motion for Summary Judgment be and the same hereby is granted and that the counterclaimant, American Empire Insurance Company of South Dakota, acting on behalf of pool participants, have and recover nothing by its claim asserted in the Count IV of the counterclaim and that the plaintiff as to said Count and said intervenor, go hence without day.

The Court further finds that the plaintiff, Fidelity and Deposit Company of Maryland is entitled to a Summary Judgment as a matter of law and it is further

ORDERED, ADJUDGED and DECREED that the plaintiff's Motion for Summary Judgment be and it is hereby granted and that the defendant, USAFORM Hail

Pool, Inc. or its receiver, have and recover nothing by its claim asserted in the Count V of the counterclaim for exemplary or punitive damages in the amount of $934,873.74 and that the plaintiff as to said claim for punitive damages by the defendant or its receiver, go hence without day.

The Court further finds that the plaintiff, Fidelity and Deposit Company of Maryland is entitled to a Summary Judgment as a matter of law and it is further

ORDERED, ADJUDGED and DECREED that the plaintiff's Motion for Summary Judgment be and the same hereby is granted and that the counterclaimant, Stuyvesant Insurance Company, acting on behalf of itself and the underwriters group for which it intervenes, have and recover nothing by its claim asserted in the Count VII of the counterclaim and that the plaintiff as to said Count and intervenor, go hence without day.

The Court further finds that the plaintiff, Fidelity and Deposit Company of Maryland is entitled to a Summary Judgment as a matter of law and it is further

ORDERED, ADJUDGED and DECREED that the plaintiff's Motion for Summary Judgment be and the same hereby is granted and that the counterclaimant, Stuyvesant Insurance Company, acting on behalf of itself and the underwriters group for which it intervenes, have and recover nothing by its claim asserted in the Count IX of the counterclaim and that the plaintiff as to said Count and intervenor, go hence without day.

The Court further finds that the plaintiff, Fidelity and Deposit Company of Maryland is entitled to a Summary Judgment as a matter of law and it is further

ORDERED, ADJUDGED and DECREED that the plaintiff's Motion for Summary Judgment be and the same

hereby is granted and that the counterclaimant, U.S. & FOREIGN MANAGEMENT, LTD. or its receiver, have and recover nothing by its claim asserted in the Count X of the counterclaim for exemplary or punitive damages in the amount of $831,925.29 and that the plaintiff as to said claim and said defendant or its receiver, go hence without day.

The Court further finds that the plaintiff, Fidelity and Deposit Company of Maryland is entitled to a Summary Judgment as a matter of law and it is further

ORDERED, ADJUDGED and DECREED that the plaintiff's Motion for Summary Judgment be and the same hereby is granted and that the counterclaimant, USAFORM Pan-American, Ltd., have and recover nothing by its claim asserted in the Count XI of the counterclaim for exemplary or punitive damages in the amount of $126,717.63, and that the plaintiff as to said claim of said intervenor, go hence without day.

The Court further finds that the plaintiff, Fidelity and Deposit Company of Maryland is entitled to a Summary Judgment as a matter of law and it is further

ORDERED, ADJUDGED and DECREED that the plaintiff's Motion for Summary Judgment be and the same hereby is granted and that the counterclaimant, Stuyvesant Insurance Company, acting on behalf of itself and the underwriting group for which it intervenes, have and recover nothing by its claim asserted in the Count XII of the counterclaim and that the plaintiff as to said Count and intervenor, go hence without day, and it is further

ORDERED, ADJUDGED and DECREED that the Clerk of this Court enter a Final Judgment upon the Summary Judgment herein dismissing Counts I, III, IV, V, VII,

IX, X, XI and XII of the Defendants' and Intervenor-Defendants' Amended Answer and Counterclaim, and the undersigned expressly determines that there is no just reason for delay in the entry of Final Judgment on this Order.

DONE AND ORDERED in Jacksonville, Duval County, Florida, this 14th day of November, A. D. 1966.

Original signed:

WM. A. McRAE, JR.,
Judge
UNITED STATES DISTRICT COURT

No. 75-1172

In The
Supreme Court of the United States

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,
Petitioner,
vs.
USAFORM HAIL POOL, INC., et al.,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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SUBJECT INDEX

OPINIONS BELOW 1

RESPONSE TO PETITIONER'S REASONS—

RESPONSE TO PETITIONER'S REASON I: The Court of Appeals' Decision That It Had Jurisdiction of This Cause (A) Is an Application of This Court's Prior Decisions, (B) Does Not Conflict With the Decision of Any Other Court of Appeals Reported to Date, and (C) Involves Such a Unique Set of Circumstances That Review by This Court Is Unwarranted 2

RESPONSE TO PETITIONER'S REASON II: Petitioner Is Complaining of an Irregularity Which Caused No Prejudice to Petitioner, Was Treated As Frivolous by the Court of Appeals, and Deserves the Same Treatment Here 12

RESPONSE TO PETITIONER'S REASON III: Petitioner's Complaints Are Predicated Upon a Misinterpretation of the Decision Below, and Are Therefore Fallacious 14

RESPONSE TO PETITIONER'S REASON IV: The Court of Appeals Did Not Alter Its 1972 Decision, but Merely Clarified It, Although It Had the Power to Alter It Through the Use of Its Sound Discretion 21

RESPONSE TO PETITIONER'S REASON V: The Court of Appeals Found That Most of the District Court's Findings Violated the Court's Prior Mandate, Constituting Clear Error 25

RESPONSE TO PETITIONER'S REASON VI: The Court of Appeals Did Not Change the Law to Be Applied and Therefore No New Trial Is Required 26

CONCLUSION 27

Index of Authorities

Cases

Brainerd v. *Beal,* 498 F. 2d 901 (7th Cir. 1974) 8, 9, 24

Brubaker v. *Board of Education, School District 149,* 502 F. 2d 973 (7th Cir. 1973) 14

Erie Railroad Company v. *Tompkins,* 1938, 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188 ....16, 20, 26

Expeditions Unlimited Aquatic Enterprises, Inc. v. *Smithsonian Institute,* 500 F. 2d 808 (D.C. Cir. 1974) 6, 12

Fidelity and Deposit Company v. *Usaform Hail Pool, Inc.,* 523 F. 2d 744 (5th Cir. 1975) 4, 20, 21

Fidelity and Deposit Company v. *Usaform Hail Pool, Inc.,* 463 F. 2d 4 (5th Cir. 1972) 15

Files v. *City of Rockford,* 440 F. 2d 811 (7th Cir. 1971) 8, 9

Geddes v. *Anaconda Copper Mining Company,* 1920, 254 U.S. 590, 41 S. Ct. 209, 65 L. Ed. 425 20

Greater Boston Television Corporation v. *FCC,* 463 F. 2d 268 (D.C. Cir. 1971) 25

Harris Truck Lines, Inc. v. *Cherry Meat Packers, Inc.,* 303 F. 2d 609 (7th Cir. 1962), rev'd 371 U.S. 125, 83 S. Ct. 283, 9 L. Ed. 2d 261 ....4, 9, 10

Hodgson v. *United Mine Workers of America,* 433 F. 2d 118 (D.C. Cir. 1972) 5, 6

In Re Morrow, 502 F. 2d 520 (5th Cir. 1974) 10, 11

Jones v. *Chaney and Janes,* 399 F. 2d 84 (5th Cir. 1968) 13

Knapp v. *North American Rockwell Corp.,* 506 F. 2d 361 (3rd Cir. 1974) 23, 24

Knox Mutual Insurance Company v. *Kallen,* 376 F. 2d 360 (6th Cir. 1967) 8

Lathrop v. *Oklahoma City Housing Authority,* 438 F. 2d 914 (10th Cir. 1971) 10, 11

Lord v. *Helmandollar,* 384 F. 2d 780 (D.C. Cir. 1965) 6

Messinger v. *Anderson,* 1912, 225 U.S. 436, 32 S. Ct. 739, 56 L. Ed. 1152 24

Moss v. *Ramey,* 239 U.S. 538, 36 S. Ct. 183, 60 L. Ed. 425 25

Nichols-Morris Corp. v. *Morris,* 279 F. 2d 81 (2nd Cir. 1960) 7

Pepper v. *Litton,* 1939, 309 U.S. 295, 60 S. Ct. 238, 84 L. Ed. 281 20

Radack v. *Norwegian American Line Agency, Inc.,* 318 F. 2d 538 (2nd Cir. 1963) 6, 12

Smith v. *Jackson Tool and Die, Inc.,* 426 F. 2d 5 (5th Cir. 1970) 10, 11, 12

Sonnenblick-Goldman Corp. v. *Nowalk,* 420 F. 2d 860 (3rd Cir. 1970) 7-8

Thompson v. *Immigration and Naturalization Service,* 1964, 375 U.S. 384, 84 S. Ct. 397, 11 L. Ed. 2d 404 .... 5, 8

Wolfsohn v. *Hankin,* 1964, 376 U.S. 203, 84 S. Ct. 699, 11 L. Ed. 2d 636 4-5

Wright v. *American Home Assurance Company,* 488 F. 2d (10th Cir. 1974) 13

STATUTES

28 USCA, §2107 ....2, 3

FEDERAL RULES

F.R.A.P. 4(a) 2
Fed.R.Civ.P. 52(a) 25, 26
Fed.R.Civ.P. 60(b)(6) 2, 3, 5, 8, 10, 11, 12
Fed.R.Civ.P. 77(d) 2, 3, 11

MISCELLANEOUS

Moore's Federal Practice (2d Ed. 1974), ¶ 0.404(1) 24

No. 75-1172

In The
Supreme Court of the United States

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,
Petitioner,

vs.

USAFORM HAIL POOL, INC., et al.,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Respondents pray that the Petition be denied.

OPINIONS BELOW

The opinion of the Court of Appeals rendered on November 20, 1975 is now officially reported at 523 F. 2d 744 (5th Cir. 1975). Respondents will refer to the opinions below by reference to Petitioner's Appendices A thru H, as well as to the official citations for those opinions which have been officially reported.

RESPONSE TO PETITIONER'S REASONS

RESPONSE TO PETITIONER'S REASON I:

The Court of Appeals' Decision That It Had Jurisdiction of This Cause (A) Is an Application of This Court's Prior Decisions, (B) Does Not Conflict With the Decision of Any Other Court of Appeals Reported to Date, and (C) Involves Such a Unique Set of Circumstances That Review by This Court Is Unwarranted.

A.

Petitioner launches its initial attack on the Court of Appeals' acceptance of jurisdiction of this cause on grounds that the Court's ruling violates the express provisions of Rule 4(a), F.R.A.P., Rule 77(d), F.R.Civ.P., and 28 USCA, § 2107.

The ruling of the Court below violates neither of the cited rules nor the statutory provision. Concisely stated, the holding of the Court of Appeals was that where there were unique circumstances present, *in addition to* the failure of the Clerk to discharge his duty under Rule 77(d), F.R.Civ.P., the District Court properly used its broad discretion under Rule 60(b)(6), F.R.Civ.P., in setting aside its judgment and re-entering it to preserve the right of appeal. This constitutes neither an application of, nor a repudiation of the rules and statute that Petitioner claims have been contravened.

Rule 4(a), F.R.A.P., provides the time for filing a notice of appeal after the entry of an appealable order or judgment, and further provides that an extension of thirty days in addition to the initial thirty days may be granted where there is a showing of excusable neglect.

Rule 77(d), F.R.Civ.P., states that the failure of the clerk to notify parties of the entry of an appealable order or judgment, *standing alone*, does not affect the time for filing the notice of appeal.

28 USCA, § 2107, similarly to Rule 4(a), F.R.A.P., provides that a court may extend the initial time for filing a notice of appeal for an additional thirty day period.

None of these provisions deal with the question of what the district court may or may not do under the authority of Rule 60(b)(6), F.R.Civ.P. Each of these provisions refers to the running of time from the entry of a judgment or order. It cannot be disputed that a district court has the authority, under some circumstances, to set aside a judgment based upon an application of Rule 60(b)(6) F.R.Civ.P. To contend otherwise is to contend that there is no sphere of application for that rule. When the court sets aside a judgment, that judgment becomes a nullity, to which the provisions of the rules and statute cited by Petitioner can have no application. If the district court properly uses its authority under Rule 60(b)(6) to set aside a judgment, and subsequently enters a new judgment, the provisions cited by Petitioner then have application only to the *new* judgment, the previous judgment then being void.

There can be no question that Respondents properly perfected their appeal from the re-entered judgment of the District Court dated January 14, 1974. The question remaining is whether or not the District Court properly used the provisions of Rule 60(b)(6) to set aside its initial judgment. While the authority of the district court under Rule 60(b)(6) should not be such

that it renders the rules and statutory provision cited by Petitioner inoperative, those rules and provision contain no express or implicit prohibition against the action taken by the District Court in this proceeding.

Petitioner has chosen to ignore most of the grounds asserted by the Court of Appeals in support of its holding that it had jurisdiction of this cause, choosing instead to represent the holding as being based upon the mere failure of the Clerk to notify counsel of the entry of the judgment. Respondents respectfully request this Court to note the carefully reasoned opinion of the Court of Appeals and consider the reasons given there for its holding. *Fidelity and Deposit Company* v. *Usaform Hail Pool, Inc.*, 523 F. 2d 744, 747-51 (5th Cir. 1975) (Pet.'s App. A., p. A-7 thru A-15). The holding is clearly based upon a finding of unique circumstances including:

1) diligent inquiry by counsel for Respondents until they were induced to cease by assurances of the Court that further inquiry was unnecessary;

2) failure of *both* sides to learn of the entry of the judgment;

3) the lack of prejudice to Petitioner;

4) the inevitability of appeal from any judgment the District Court could possibly have rendered.

Contrary to Petitioner's inference that this Court has not considered whether a district court in the exercise of its equity jurisdiction may restore an otherwise lost right to appeal, the "unique circumstances" doctrine has its origin in prior decisions of this Court. *Harris Truck Lines, Inc.* v. *Cherry Meat Packers, Inc.*, 1962, 371 U.S. 125, 83 S. Ct. 283, 9 L. Ed. 2d 261. *Wolfsohn* v. *Hankin*, 1964, 376 U.S. 203, 84 S. Ct. 699, 11 L. Ed. 2d 636, reh. den. 376 U.S. 973, 84 S. Ct. 1133, 12 L. Ed. 2d 87. *Thompson* v. *Immigration and Naturalization Service*, 1964, 375 U.S. 384, 84 S. Ct. 397, 11 L. Ed. 2d 404.

The *Thompson* case involved the same element of reliance on actions of the district court that was present in this case. In that case, the district court assured counsel that his post-judgment motions were timely and therefore tolled the running of the time for filing the notice of appeal. Counsel did not file a notice of appeal in reliance on this assurance until the court disposed of these motions. This Court concluded that counsel's reliance on the district court's statement that his motions were timely was reasonable, and that this constituted "unique circumstances" justifying the acceptance of jurisdiction.

While the *Thompson* case was not a Rule 60(b)(6), F.R.Civ.P., case, its rationale is identical to that applied by the Court below in holding that the District Court properly exercised its broad discretion under Rule 60(b)(6).

B.

Petitioner claims that conflict exists among the Courts of Appeal on this question. When the decisions cited by Petitioner as being in conflict with the decision of the Court below are closely analyzed, no conflict is found among the circuits on the narrow ground upon which the Court below held that it had jurisdiction.

Petitioner places primary reliance on *Hodgson* v. *United Mine Workers of America*, 433 F. 2d 118 (D.C.

Cir. 1972), and also cites the decision of the same Circuit in *Lord* v. *Helmandollar,* 384 F. 2d 780 (D.C. Cir. 1965), cert. den. 383 U.S. 928, 86 S. Ct. 929, 15 L. Ed. 2d 874, as being in conflict with the decision below. However, Petitioner has ignored the later decision of that Court in *Expeditions Unlimited Aquatic Enterprises, Inc.* v. *Smithsonian Institute,* 500 F. 2d 808 (D.C. Cir. 1974), which was cited by the Court below as being in accord with its decision in this case. 523 F. 2d at 750 (Pet.'s App. A, p. A-13). The court in *Expeditions Unlimited* distinguished both the *Hodgson* and the *Lord* cases on the grounds that 1) in each of those cases, counsel knew of the entry of the judgment in the time to perfect their appeals, and 2) there was no reliance on any action by the clerk or the district court in these cases which caused the problem. These elements are clearly present in this case, making it accord with the most recent holding of the Court of Appeals for the District of Columbia, and distinguishable from the prior decisions of that Court relied upon by Petitioner for conflict.

The decision cited by Petitioner from the Court of Appeals for the 2nd Circuit, *Radack* v. *Norwegian American Line Agency, Inc.,* 318 F. 2d 538 (2nd Cir. 1963), not only fails to conflict with the decision below, but in fact *supports* Respondents' position. Petitioner's one sentence description of *Radack* is extremely misleading, to the extent that it does not accurately portray the meaning of the paragraph from which it was taken, not to mention the holding of the case. The rest of the paragraph is crucial to the court's decision:

> "The rule [Rule 60(b)(6)] cannot be used to circumvent the 1947 Amendment to Rule 77(d) dealing with the effect of lack of notice on the running of time for appeal [cite omitted] nor is 60(b)(6) relief available for an unlimited time. The rule is still subject to both the reasonable time limitation and to the proper exercise of discretion by the district court considering all the circumstances present in a given case. The granting of such motion should be considered only when lack of notice has operated to prejudice a substantial right or remedy that would otherwise have been available." 318 F. 2d at 542-43.

The next to the last sentence of the opinion is also vital:

> "But if notice of the judgment was not sent, the judge has the power, in the exercise of a sound discretion, to grant relief under 60(b)(6)." 318 F. 2d at 543.

This case is one of the few cases cited by the Petitioner which involves the precise issue presented here, and actually *supports* the decision below.

The second case cited from the Second Circuit, *Nichols-Morris Corp.* v. *Morris,* 279 F. 2d 81 (2nd Cir. 1960), involved a denial of a motion to extend the time for appeal which was filed after the expiration of the initial 30 day period, and which stated no reasons which justified a finding of excusable neglect. In that case, counsel had notice of the judgment two days after it was entered but simply did nothing. This case has no bearing on the issue involved in the decision below and therefore cannot be in conflict with it.

From the Third Circuit, Petitioner has cited the case of *Sonnenblick-Goldman Corp.* v. *Nowalk,* 420 F.

2d 860 (3rd Cir. 1970). In that case, counsel filed an untimely motion which would have tolled the time for filing the notice of appeal had it been timely made. Unlike the *Thompson* case, *supra,* counsel relied on no action of the district court in failing to file the notice of appeal, and did not even bother to file a motion to extend the time for filing the notice based upon excusable neglect, although he had ample time to do so. This case did not involve an application of Rule 60(b)(6) F.R.Civ.P., and has no factual resemblance to the case at bar.

Petitioner cites from the Sixth Circuit *Knox Mutual Insurance Company* v. *Kallen,* 376 F. 2d 360 (6th Cir. 1967). In that case, the Court dismissed a cross appeal as untimely filed. The initial appeal was timely only by reason of an extension of time granted by the district court for excusable neglect. Without securing a similar extension, cross-appellant merely filed his cross appeal assuming that he was entitled to the benefit of the extension given to the appellant. This case does not involve failure to receive notice of a judgment, or reliance upon any action of the clerk or court, and does not involve an application of Rule 60(b)(6). In fact, it does not even involve a review of a denial for an extension of time based upon excusable neglect, since no such extension was requested by the cross-appellant. As the court there pointed out, there was no issue involved regarding whether the appellant had notice of the order, since the appellant had *prepared* the order he sought to appeal, and had submitted it to the court for signature. 376 F. 2d at 364.

Two cases are cited for conflict from the 7th Circuit, *Files* v. *City of Rockford,* 440 F. 2d 811 (7th Cir. 1971), and *Brainerd* v. *Beal,* 498 F. 2d 901 (7th Cir.

1974). It takes but a brief quotation to show the lack of conflict between the *Files* case and the decision below:

> "The order dismissing the complaint in this cause was entered October 6, 1969 in open court. All parties were present in court by counsel. There is no contention that the clerk failed to give notice of the entry of said order to attorneys for all parties. See Rule 77(d) F.R.Civ.P." 440 F. 2d at 813.

The court further noted that the lower court had merely purported to extend the time for filing the appeal and neither the motion requesting the extension, nor the order granting it, recited any grounds for finding excusable neglect. The court also independently reviewed the record and determined that no such grounds were present even if appellant had sought the extension on this basis. The court acknowledged the "unique circumstances" exception, but held that none were present in that case.

In *Brainerd, supra,* the notice of appeal was filed more than thirty days beyond the entering of the judgment, and no request for extension based upon excusable neglect was made. There was no contention that counsel did not have notice of the entry of the judgment, and the court in independently reviewing the record, found no facts to support a finding of excusable neglect had counsel sought an extension on that ground. Although this case does not present conflict, it is interesting to note that the court cited its previous opinion in *Harris Truck Lines, Inc.* v. *Cherry Meat Packers, Inc.,* 303 F. 2d 609 (7th Cir. 1962) in support of its ruling. This is the case, which on appeal to this Court,

was reversed resulting in the creation of the "unique circumstances" doctrine. *Harris Truck Lines, Inc.* v. *Cherry Meat Packers, Inc.*, 1962, 371 U.S. 125, 83 S. Ct. 283, 9 L. Ed. 2d 261.

Finally, from the 10th Circuit, Petitioner has cited the case of *Lathrop* v. *Oklahoma City Housing Authority,* 438 F. 2d 914 (10th Cir. 1971), cert. den. 404 U.S. 940, 92 S. Ct. 132, 30 L. Ed. 2d 73. In *Lathrop,* there was a simple failure to file the notice of appeal on time, which appellant tried to overcome by the sole allegation that notice of the judgment had not been received. Nothing was cited in the opinion regarding whether or not counsel had attempted to learn of the judgment prior to the running of the appeal time, and no reliance on any action taken by the clerk or the court was cited. While Petitioner would like this Court to believe that this is the factual setting of the present case, both the order of the District Court setting aside its first judgment (Pet.'s App. C, p. C-1 thru C-5) and the decision of the Court below demonstrate that it is not.

Further evidence of the lack of conflict of the decision below with *Lathrop, supra,* is found in the Fifth Circuit's analysis of its own prior decisions in *Smith* v. *Jackson Tool and Die, Inc.*, 426 F. 2d 5 (5th Cir. 1970), and *In Re Morrow,* 502 F. 2d 520 (5th Cir. 1974). In *Smith,* counsel for appellant had requested the court to delay entering its judgment, and opposing counsel agreed to the delay. Without notifying counsel for appellant, the court entered judgment, and neither side was informed of its action. In that case, the Fifth Circuit held that there were unique circumstances *in addition to the failure of the clerk to notify the parties of the judgment* which justified setting aside the judgment under 60(b)(6).

In *Morrow, supra,* there was nothing in addition to the failure of the clerk to notify the parties. In that case, just as the Tenth Circuit did in *Lathrop, supra,* the Fifth Circuit refused to uphold the setting aside of the judgement to preserve the right of appeal. A reading of the decision of the Court of Appeals in this case will show that the Court carefully considered its prior decisions in *Smith* and *Morrow,* and found that in the case at bar, just as in *Smith,* there were additional unique circumstances over and above the failure of the clerk to give notice. Accordingly, the *Lathrop* case does not present a conflict with the decision of the Court below, and is in accord with the similar decision of the Fifth Circuit in *Morrow.*

Respondents regret that Petitioner's mere listing of cases claimed to be in conflict with the decision below necessitated this lengthy analysis of largely inapposite cases, but the analysis demonstrates that there is no conflict among the circuits on the narrow issue raised by the Fifth Circuit's holding that it had jurisdiction of this cause.

C.

Petitioner's contention that the jurisdictional issue involved here is of equal importance to those instances where this Court has granted certiorari to determine the question of when a judgment becomes final is a gross exaggeration. Resolution of the jurisdictional issue involved in this appeal by this Court would only affect those extremely rare instances in which the clerk of the district court fails to discharge his simplest and most clearly mandated duty under Rule 77(d), and in which there are *additional unique circumstances* justifying the exercise of the court's discretion under Rule 60(b)(6).

The resolution of the true issue involved in the Court of Appeals' holding relating to jurisdiction would not have any effect whatsoever on the decisions cited by Petitioner for conflict, except *Radack, supra,* since all of them are distinguishable on their facts. The only decisions which could possibly be affected by a review by this Court are the decisions in *Expeditions Unlimited, Radack,* and *Smith, supra,* all of which support the Fifth Circuit's decision. These cases represent an infinitesimal percentage of the cases reaching the appellate level of the Federal court system.

Surely this Court need not spend its valuable time ruling on a question which only arises as a result of a rare failure on the part of both a District Court and its Clerk, and which has as its basic premise the proposition that the district courts cannot fairly discharge their duty under Rule 60(b)(6) in these very limited instances, and that the courts of appeal cannot fairly review such decisions.

RESPONSE TO PETITIONER'S REASON II:

Petitioner Is Complaining of an Irregularity Which Caused No Prejudice to Petitioner, Was Treated As Frivolous by the Court of Appeals, and Deserves the Same Treatment Here.

Petitioner's reason II also grossly overstates the import of the Court of Appeals' decision. Reason II claims that the Court of Appeals has attempted to revolutionize appellate procedure by dispensing with the requirement of filing a notice of appeal.

The minor irregularity that gives rise to Petitoner's complaint is not fatal to the claims of Usaform Pan American Limited ("Pan Am"), and can be easily explained.

Petitioner's complaint is that Pan Am did not file a notice of appeal from the judgment of the District Court. In truth, what happened is that Pan Am's *name* did not appear in the listing of appellants contained in the notice of appeal. When one examines the first page of the District Court's "Findings of Fact and Conclusions of Law" and "Final Judgment", both as entered on August 2, 1973 (Pet.'s App. D, p. D-1 and D-26) and as re-entered on January 14, 1974 (Pet.'s App. B, p. B-1 and B-26), the source of the irregularity is easily seen. The listing of the parties defendant in the style of those documents lists all of the Respondents *except* Pan Am, although Pan Am's claims are adjudicated therein. Respondents were understandably hasty in filing their notice of appeal from the re-entered judgment of the District Court, and the error is easily explained as resulting from taking the listing of appellants from the District Court's listing in the judgment being appealed. The error is obviously clerical and one of mere oversight.

It should be noted that this point was raised in the court below, albeit half-heartedly, and the Court of Appeals apparently thought it frivolous to the point of not deserving mention, there being not one sentence on this point in the Court of Appeals' lengthy opinion.

It is the filing of a notice of appeal which reasonably apprises the opposing party that an appeal is being taken that is required by the rules. It has been held on numerous occasions that irregularities in the notice will not be considered fatal where no prejudice to the opposing party occurs. *Jones* v. *Chaney and Janes*, 399 F. 2d 84 (5th Cir. 1968), *Wright* v. *American Home Assurance Company,* 488 F. 2d (10th Cir. 1974).

In *Brubaker* v. *Board of Education, School District 149,* 502 F. 2d 973 (7th Cir. 1973), cert. den. 419 U.S. 1039, 95 S. Ct. 1953, the court found no trouble in overlooking the absence of a party's name in the notice of appeal, where the intent of the notice was apparent and no prejudice could have occurred to the opposing party.

It is not surprising that Petitioner has not attempted to allege that it was prejudiced by the irregularity. It had been engaged in litigation with Pan Am along with the other Respondents for eleven years when the notice of appeal was filed (including two previous appeals to the Fifth Circuit); the last proceeding before the District Court had involved no new facts and involved an application of the same legal principles between Petitioner and all Respondents *including Pan Am;* the notice of appeal accurately referred to the findings, conclusions and final judgment which were entered against all Respondents *including Pan Am* in the same documents and on the same legal grounds. In fact, Petitioner could have made no other conclusion on receipt of the notice of appeal than that Pan Am's name did not appear due to a clerical error. This was the case beyond question.

RESPONSE TO PETITIONER'S REASON III:

Petitioner's Complaints Are Predicated Upon a Misinterpretation of the Decision Below, and Are Therefore Fallacious.

Petitioner's reason III is predicated upon a serious misinterpretation of the decision of the Court of Appeals.

Petitioner seeks to attribute to the decision of the Court of Appeals an intention to ignore or misapply state law in a diversity suit, to create new presumptions never before known, and to place a burden of proof on Petitioner that it should not be required to bear.

Petitioner gets off on the wrong foot immediately by attributing to the Court of Appeals a quotation which was in fact the language of the District Court in its first opinion (Pet., p. 28). It is true that the Court of Appeals adopted as controlling the quoted language to the effect that Petitioner, in issuing the bond, walked into the loss with its eyes wide open. However, the reason that the Court of Appeals adopted this language as controlling was that the Court's 1972 opinion in this case *specifically affirmed* that District Court finding, and not because of any preconceived intention of the Court of Appeals to ignore the language of the bond, nor because of any prejudice against Petitioner by the author of the opinion. (Petitioner insists on insinuating the existence of such prejudice throughout the Petition, without foundation.)

Unfortunately, the extent of the confusion generated by Petitioner in its reason III requires going back to the previous decision of the Court of Appeals (referred to as the 1972 opinion) for clarification. *Fidelity and Deposit Company of Maryland* v. *Usaform Hail Pool, Inc.*, 463 F. 2d 4 (5th Cir. 1972) (Pet.'s App. E). That decision, while not carefully defining the sole legal principle to be applied on remand in the District Court, nevertheless limited remand to one narrow issue—whether or not monies diverted from premium accounts of an insured corporation were used for legitimate corporate obligations of *that corporation.* With respect to the remaining issues, the Court stated:

"We have carefully reviewed all other grounds asserted by appellant and affirm the District Court in all other respects." 463 F. 2d at 7 (Pet.'s App. E, p. E-6),

thereby eliminating these issues on remand.

The District Court's decision following remand sought to go back and alter many of the findings and conclusions which had been foreclosed by the above-quoted language of the 1972 decision of the Court of Appeals. The action of the Court of Appeals in disregarding the findings and conclusions of the District Court on issues which were not open to it on remand therefore does not constitute a violation of the doctrine of *Erie Railroad Company* v. *Tompkins,* 1938, 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, as Petitioner would have this Court believe. It is a simple application of the doctrine of the law of the case and the superiority of the Court of Appeals over the District Court. Once the Court of Appeals had previously considered, and specifically affirmed, the findings of the District Court, they were no longer open for further consideration by the District Court.

The fact that this was the rationale of the decision of the Court of Appeals in this case is easily illustrated by reference to the opinion. Citing the *first* decision of the District Court, the Court below stated:

"The trial court rendered a carefully considered opinion and made findings of facts, *many of which govern the present appeal.*" (Emphasis supplied) 523 F. 2d at 751 (Pet.'s App. A, p. A-16).

Later, again referring to the *first* District Court decision, the Court said:

"The [District] Court did not address the issue of whether the uses to which the wrongfully transferred funds were put were 'legitimate' or 'proper' corporate purposes. This turned out to be the only issue upon which we remanded the case to the District Court in our 1972 opinion." 523 F. 2d at 754 (Pet's. App. A, p. A-21).

Further along, the Court said:

"The District Court in its first opinion had carefully analyzed the claimants' position on a company-by-company basis. 318 F. Supp. 1301. That approach was in no way challenged by this Court; rather, we took care to state that the District Court's determination was affirmed in all other respects. 463 F. 2d at 7." 523 F. 2d at 756 (Pet's. App. A, p. A-26).

Additional examples are:

"The findings of fraud and dishonesty were clear and pervasive in the District Court's first opinion, and they were affirmed in our 1972 opinion. The issue on remand was loss—whether the wrongfully appropriated monies went to pay legitimate corporate obligations (in which case there would be no 'loss') or whether they were made for any other purpose (in which case there would be a 'loss')." 523 F. 2d at 757 (Pet.'s App. A, p. A-26).

* * *

"The District Court in its earlier opinion found that 'the named insureds were *all insolvent at all times* when the . . . illegal transfers were being made. . .' 318 F. Supp. at 1308 (emphasis added). Because the only issue on remand from our 1972

decision was whether the wrongfully appropriated funds were used to pay legitimate corporate obligations, this finding—indeed, all findings and conclusions of the District Court in its first opinion not germane to the issue on remand—were binding upon the District Court." [Cites omitted] 523 F. 2d at 759 (Pet's. App. A, p. A-30, 31).

* * *

"We repeat that the Court's earlier findings of fraud and dishonesty were affirmed by this Court in its 1972 opinion and were not open to reconsideration on remand." 523 F. 2d at 762 (Pet's. App. A, p. A-38).

* * *

"The District Court has acted conscientiously and has taken great pains throughout the course of this litigation. Our examination of record leaves us to conclude, however, that the Court misapprehended the mandate of the 1972 opinion of this Court." 523 F. 2d at 767 (Pet's. App. A, p. A-48, 49).

With this analysis of the decision of the Court of Appeals in mind, Petitioner's contentions fall like a house of cards.

Petitioner contends that the Court of Appeals eliminated the requirement of showing that loss under the bond was caused by fraud and dishonesty. What the Court said was that the requirement of proving fraud and dishonesty to the extent necessary for recovery under the bond had *already been proven* by Respondents, and was no longer an issue in the case. The status of the case following the prior appeal was that fraud and dishonesty as a *causative element* had been

proven, and the sole and critical question remaining was where the fraudulently diverted money went. The entire meaning of the 1972 opinion was that it is possible to have fraud and dishonesty on creditors of the insured corporation without a loss to the insured corporation, but where the fraud and dishonesty in a continuous sequence of events results in an expenditure for non-legitimate reasons, viewed from the perspective of the insured corporation, a loss occurs as defined in the bond. Accordingly, while the issue on remand was broadly referred to as "loss", it was really whether or not only one of the many elements of loss was present, all of the other necessary elements for proving loss having already been proven.

Petitioner's argument that the Court of Appeals shifted the burden of proof of loss also collapses under analysis. The Court of Appeals first noted that the vast bulk of the burden to be carried by Respondents *has* been carried. The one issue remaining to be decided on remand affects the whole question of whether there will be any recovery and was thus broadly referred to by the Court as the question of whether there was a "loss". The real issue is whether the diverted funds were expended for "legitimate" corporate purposes, which constitutes but one small part of the many-faceted issue of "loss". The vast majority of the expenditures claimed by Respondents *not* to be legitimate expenditures were intercorporate transfers among corporations with common ownership, directors and officers, and transfers between these corporations and their officers and employees. Where such transfers occur, the general rule of law in America is that the burden of showing legitimacy of such transfers is on the parties intending to uphold them (or on the parties relying

upon the legitimacy of such transfers, such as Petitioner). The burden of proving all of the other elements of loss has always been rightfully placed upon Respondents, as claimants under the bond, and has been carried by them. The single remaining element involved being "legitimacy", and Respondents having carried the burden of showing the necessary interlocking and fiduciary relationships of the transferors and transferees, the burden of proving legitimacy under these undisputed factual circumstances shifts to Petitioner.

Petitioner complains that the Court of Appeals did not apply state law and relied upon a pre-*Erie* case in placing the burden of proof of legitimacy of the intercorporate transfers on Petitioners. However, Petitioners cite no authority for the proposition that this is not the law of the respective states whose law controls under the circumstances. The Court of Appeals chided Petitioner for this same failure. The Court below, in referring to the pre-*Erie* case of *Geddes* v. *Anaconda Copper Mining Company,* 1920, 254 U.S. 590, 41 S. Ct. 209, 65 L. Ed. 425 stated:

> ". . . Fidelity [Petitioner] has not countered the claimants' assertion that the *Anaconda* principles apply to the corporations involved in this case. The full implications of applying those principles to the present case may be further developed on remand." 523 F. 2d at 760 (Pet's. App. A, p. A-31).

Therefore, while the Court assumed that Respondents were correct in claiming that *Anaconda* and the case of *Pepper* v. *Litton,* 1939, 308 U.S. 295, 60 S. Ct. 238, 84 L. Ed. 281 control the burden of proof issue, it left room for the District Court on remand to further explore that issue.

Petitioner also paints with a broad brush in claiming that the Court has ignored state law in this diversity suit on the issue of construing an unambiguous contract. However, Petitioner cites only vague and general Florida law that courts cannot ignore the language of unambiguous contracts. The question of ambiguity is one of fact, depending upon the circumstances of the transaction. The Court of Appeals agreed with the Petitioner that the contract was not ambiguous under the circumstances—it simply did not agree with Petitioner's view of what the contract clearly says. If the Court had found that there was ambiguity, it would have resolved it against Petitioner, the bond having been drafted and issued by Petitioner with full knowledge of the factual context existing with respect to the insureds. 523 F. 2d at 755 (Pet's. App. A, p. A-22).

Careful analysis of the Court of Appeals' decision shows that it is guilty of none of the offenses charged in Petitioner's reason III, and further affirmatively shows that it followed the essential requirements of law in holding the District Court to the mandate of the 1972 opinion.

RESPONSE TO PETITIONER'S REASON IV:

The Court of Appeals Did Not Alter Its 1972 Decision, but Merely Clarified It, Although It Had the Power to Alter It Through the Use of Its Sound Discretion.

Petitioner's contention that the Court of Appeals altered its 1972 decision in the 1975 decision, which the Petition seeks to have reviewed, is afflicted with the same misapprehension of the decision below that pervades the other points Petitioner attempts to raise.

Petitioner's argument begins:

"In violation of both the contract and that opinion [1972 opinion], the Court relied solely on the district court's earlier vacated findings of fraud and dishonesty as to the invasion of the so-called trust funds. . ." (Pet., p. 33).

The excerpts cited above under Respondents' response to reason III catalogue the Court of Appeals' repeated statements that the previous findings relating to fraud and dishonesty were *not* vacated, but rather were specifically *affirmed by* the 1972 opinion.

The Court of Appeals did not undertake to modify the 1972 opinion, but simply sought to clarify it for the benefit of the District Court, whose decision had shown that it was obviously confused by the 1972 decision. All of the Court's references to its 1972 decision are stated in terms of clarification of points on which confusion may have arisen. Not once did the Court of Appeals indicate an intention to deviate from its prior opinion, and it cannot be said that the decision below is clearly inconsistent with the 1972 decision.

Petitioner contends that there was some support in the 1972 opinion for its lately contrived theory that any legitimate corporate purpose of any of the joint insureds is necessarily a legitimate purpose of the others. The Court of Appeals took pains in its recent decision to point out the clear and simple language of the 1972 opinion which should have laid this phony argument to rest, to wit:

"The reference to 'wash transactions' . . . might be taken to imply that in a case involving a group of corporations related by common ownerships, transactions among corporations are not pr ected by the bond unless the net financial condition of all of the corporations considered together as one were impaired. Our holding in the earlier appeal . . . dispels any such notion when carefully read. It fairly indicates that each corporate tub must stand upon its own bottom. This follows from the reference to 'the taking of money from the premium accounts of an insured company to pay other legitimate obligations of *that company.*' 463 F. 2d at 7." (Emphasis is the Court's) 523 F. 2d at 756 (Pet's. App. A, p. A-25).

While vigorously opposing any contention that the Court of Appeals, with or without intending to do so, altered its 1972 opinion in the decision below, Respondents ask the Court to note that if this were the case, the Court of Appeals had complete power to do so, in the exercise of its discretion, if it determined that its prior decision was erroneous.

It is not surprising that the only case cited by Petitioner for the proposition that the Court acted outside its authority is weak, inapposite, and is probably erroneous in its holding. In that case, *Knapp v. North American Rockwell Corp.*, 506 F. 2d 361 (3rd Cir. 1974), the Court made the observation in a footnote that since a different panel of the same Court had previously denied a motion to dismiss for lack of jurisidiction, the panel hearing the merits of the case had no power to reconsider that issue. The first distinction to be made is that the Court there was referring to a ruling on an issue which had already been decided by another panel on the *same* appeal, whereas the present case involves a consideration of a prior decision of the Court in the same case rendered three years earlier, in light of an in-

tervening decision of the District Court on remand. Accordingly, the vision that Petitioner seeks to impart of panels of the same Court of Appeals endlessly feuding over an issue is a mirage.

Secondly, it is generally held that the issue of jurisdiction, which was involved in the *Knapp* case, is *always* open to reconsideration. *Brainerd* v. *Beal*, 498 F. 2d 901 (7th Cir. 1974) (footnote 2, at 902), and thus, *Knapp* was probably erroneous.

Petitioner's argument appears to be that the "law of the case" doctrine prevents the Court below from altering its 1972 opinion. While the "law of the case" doctrine and the superiority of courts of appeals over district courts required the District Court below to adhere to the portions of its first decision affirmed by the 1972 opinion of the Court of Appeals, that doctrine does not prohibit the Court of Appeals from reconsidering its *own* decisions, even those rendered on prior appeals in the same case. This Court has held that the "law of the case" doctrine is a rule of general application, but does not constitute a limitation on the power of an appellate court, acting within its sound discretion, to reconsider its prior rulings in a case. *Messinger* v. *Anderson*, 1912, 225 U.S. 436, 32 S. Ct. 739, 56 L. Ed. 1152.

Consider also the following excerpt from Moore's Federal Practice:

> "While there is considerable authority in federal cases, usually the older ones, to the effect that the law of the case has the effect of res judicata, the present federal view is *contra* and the doctrine of the law of the case does not carry the same consequences as the rule of res judicata." Moore's Federal Practice (2d Ed. 1974), ¶ 0.404(1), p. 405-406.

See also *Greater Boston Television Corporation* v. *FCC*, 463 F. 2d 268 (D.C. Cir. 1971).

This Court has also held that due process does not compel an appellate court to follow its previous ruling in the same case on subsequent appeals to the same court. *Moss* v. *Ramey*, 1920, 239 U.S. 538, 546-47, 36 S. Ct. 183, 60 L. Ed. 425.

Petitioner has failed to demonstrate any reason why the Court of Appeals abused its discretion, even if it could be demonstrated that any alteration of the 1972 opinion occurred in the recent opinion. No such alteration occurred, and Petitioner has not shown any valid reason why the decision of the Court of Appeals should be reviewed on this issue.

RESPONSE TO PETITIONER'S REASON V:

The Court of Appeals Found That Most of the District Court's Findings Violated the Court's Prior Mandate, Constituting Clear Error.

Petitioner's reliance on the "clearly erroneous" doctrine of Rule 52(a), F.R.Civ.P., contains the same basic fallacy as Petitioner's other contentions.

Petitioner begins its attack by stating that the opinion of the Court of Appeals is "wholly devoid of any finding of evidentiary inadequacy of the elaborate findings prepared and filed by the District Court" (Pet., p. 35).

Petitioner fails to give any weight to the basic premise of the Court of Appeal's decision that the District Court was *not authorized* to make most of the findings of fact that it purported to make. What could be more clearly erroneous in the actions of a district court than entering findings which it is *not allowed* to make? The unauthorized findings pervaded the Dis-

trict Court's decision (constituting more than half of the total findings), which would have merited reversal standing alone. Nevertheless, the Court of Appeals, in the hope of providing guidance for subsequent proceedings, went ahead and examined additional findings which the District Court was arguably authorized to make, pointing out in each instance why these findings were irrelevant to the issue before the Court, and why others were clearly erroneous in light of the evidence.

There is no Rule 52(a) issue present here, and therefore no need for Respondents to discuss the cases Petitioner contends are in conflict with the decision of the Court of Appeals.

RESPONSE TO PETITIONER'S REASON VI:

The Court of Appeals Did Not Change the Law to Be Applied and Therefore No New Trial Is Required.

Petitioner again raises an issue which would be appealing but for the lack of a predicate in the previous proceedings to support its contentions.

Petitioner's reason III had contended that the Court of Appeals changed the law applicable to this case, or ignored the applicable law, contrary to the *Erie* doctrine. Petitioner now claims in its reason IV that if the change in the law *was* properly made, Petitioner should be allowed to retry this cause under the "new" principles. Perhaps Petitioner's ulterior motive is to try to wriggle out of what now appear to have been inadvisable stipulations and to send Respondents back to prove events which happened more than thirteen years ago, prior to commencement of this litigation.

It would probably come as a surprise to the Court of Appeals to learn that it broke new ground in its de-

cision regarding the issue of burden of proof. The Court of Appeals merely applied the general American rule regarding transactions between closely related corporations which was urged by Respondents to be the applicable law in this case, and the Court further noted the absence of any showing by Petitioner that such was not the law to be applied. In addition, the Court left the District Court to explore the full implications of applying these principles on remand.

It remains the duty of the District Court on remand to apply the applicable law in effect at the pertinent times to determine the legitimacy of the corporate transfers. The decision of the Court of Appeals recognizes that the full factual context of these transfers is covered by the record of the trial, primarily by stipulations as to indisputable facts. 523 F. 2d at 751-52 (Pet.'s App. A, p. A-16).

Petitioner, a professional surety which received a premium for the protection it has doggedly fought to avoid for thirteen years, now claims at this late date the right to re-try this case, underscoring its determination to avoid to the bitter end the payment of just claims of Respondents which are amply supported in the trial record.

CONCLUSION

Respondents have demonstrated that Petitioner's reasons for requesting review by this Court are based on erroneous predicates not supported by the prior proceedings in this cause nor by the authorities it cites, and it is respectfully requested that the Court deny the

Petition in order that this cause, which has been too long pending, may reach its just resolution.

Respectfully submitted,

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In The

Supreme Court of the United States

No. 75-1172

October Term, 1975

Fidelity and Deposit Company of Maryland,

Petitioner,

v.

Usaform Hail Pool, Inc., *Et Al.*,

Respondents.

PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, which was entered on November 20, 1975.

INTRODUCTION

In filing this Reply to Respondents' Brief in Opposition to its Petition for Writ of Certiorari Petitioner expressly recognizes that its reply is confined to "new" matters raised in Respondents' brief that were not originally addressed in the petition. Accordingly, Petitioner will not re-argue or re-urge its original arguments and authorities already developed in its original petition. However, Respondents' misanalysis of Petitioner's contentions requires correction. Since the record in the Court of Appeals is not presently before the Court, Petitioner urges the following additional considerations in clarification of its original Petition and in reply to Respondents' brief.

I.

This Petition for Certiorari Involves the Fundamental Question of the District Court's Jurisdiction over its own "Final" Judgments under Fed. R. Civ. P. 60(b) To Restore a Lost Right of Appeal in a Case that had Already Been Fully Tried on its Merits.

Petitioner notes Respondents' misstatement of Rule Fed. R. Civ. P. 77(d) that appears on page 3 of Respondents' Brief. Respondents assert that Rule 77(d) "states that the failure of the clerk to notify parties of the entry of an appealable order or judgment, *standing alone*, does not affect the time for filing the notice of appeal". [Emphasis in original].

The "standing alone" language does not appear in Rule 77(d) of the Federal Rules of Civil Procedure. Respondents' attempted enlargement of the rule by adding these two words is impermissible as demonstrated in the Petition for Certiorari.

Moreover, Respondents' entire argument in reply to Petitioner's first reason for granting certiorari wrongfully assumes a premise nonexistent in the very question which Petitioner asked this Court to determine. Specifically, Respondents' opposition brief, p. 3, states, both as premise and conclusion, that the District Court properly exercised its authority under Rule 60(b)(6) of the Federal Rules of Civil Procedure in setting aside its previous judgment and reentering it in order to permit an appeal after expiration of the time allowed by law. The propriety of such action is the precise question which Petitioner has presented for review. The first question presented is whether the trial court has jurisdiction under the aegis of Rule 60(b)(6) to vacate and reenter its previously "final" judgments in disregard of the limitations expressly provided by Congress.

Respondent erroneously argues at p. 3 in Brief:

> "When the Court sets aside a judgment, that judgment becomes a nullity to which the provisions of the rules and statutes cited by Petitioner can have no application. If the District Court properly uses its authority under Rule 60(b)(6) to set aside a judgment and subsequently enters a new judgment, the provisions cited by Petitioner then have application only to the new judgment, the previous judgment then being void."

If accepted, this argument is tantamount to permitting the trial court to continuously exercise jurisdiction under Rule 60(b)(6) to set aside its previous judgments. Under this argument the court not only may reenter them in order to permit an untimely appeal, but it also may change its judgment and readjust the rights of the litigants under the prior judgment. Petitioner's petition vigorously opposes this unjustifiable extension of the District Court's general jurisdiction to vacate, alter or modify its judgments in cases which have already been tried on their merits.

The record of the Court of Appeals unmistakably reveals that Respondents' application for relief from judgment under Rule 60(b)(6) was based solely on the grounds:

> "That the Court based its judgment of August 2, 1973, on altered findings of fact which were contrary to the law of the case."

Thus, Respondents urged the District Court to enter a new judgment on the merits under Rule 60(b)(6), not to reenter the old judgment. Respondents' asserted position vitally endangers the finality of any judgment on the merits. When shall litigation end? The Congress has provided an answer, and it is that answer which stands challenged by the current opinion of the Fifth Circuit Court of Appeals.

Respondents finally urge that their argued construction of Rule 60(b) arises under such a unique set of circumstances as not to warrant review. To the contrary, the question of timely filing of notice of appeal arises in every appeal. It is significant to note the trial court's own justification of "unique circumstances" for the relief from its judgment. In the order granting the Rule 60(b)(6) relief, the Court noted the following seven reasons that are virtually identical to those urged by the Fifth Circuit Court of Appeals. Those seven articulatd reasons are:

> "(1) The legal issues and factual background are complex, (2) Nearly $1,000,000.00 is involved, (3) The cause has been in litigation for nearly ten years, (4) The cause was under advisement for six months before the judgment was entered, (5) The failure of the clerk or Court to notify litigants of the judgment, (6) The failure of all litigants to learn of the judgment during the allowable appeal time, and (7) The anticipation of an appeal by all

litigants . . ." (District Court order, page 2, filed January 14, 1974)

Thus, the unique circumstances consist of the clerk's failure to notify the party litigants of a judgment in an old and complex lawsuit involving a large ad damnum. These circumstances do not render this particular case so unique as to justify ignoring the clear Congressional mandates in 4(a) and 28 U.S.C.A. § 2107. To the contrary, the Advisory Committee's recommendations that were adopted in Rule 77(d)were specifically directed at this problem. Petitioner concedes that the Court of Appeals expanded on the District Court's holding by asserting that none of the parties had been prejudiced. It is impossible for a defendant who has won a large lawsuit to ever demonstrate prejudice from the failure of the opposing party to take an appeal, except by claiming his statutory right to a final judgment. What if the defendant had received notice of the entry of the judgment and the plaintiff had not? Would that change in circumstance significantly differ from the present facts so as to avoid application of the rule articulated by the lower court? What if the clerk swore that he had mailed it, and the attorney swore that he had not received it? Would that justify relief under Rule 60(b)(6)? Respondent argues that that determination is an act of discretion by the District Court. That argument totally and completely sacrifices the language and clear intent of the Federal Rules. Respondent claims that the relief is justified by circumstances in *addition* to the clerk's failure to notify. However, that is the only circumstance extant in *Expeditions Unlimited Aquatic Enterprises, Inc.* v. *Smithsonian Institute,* 500 F.2d 808 (D.C. Cir. 1974) which Respondents cite and rely upon.

It is of vital concern to all federal litigants to determine whether Congress really intended for there to be an end to litigation. Just as parties may not agree to jurisdiction in the District Court when there is none, there must be no affirmative burden to show prejudice on the part of an appellee when an appellant desires to take an untimely appeal. If the court has jurisdiction under Rule 60(b) to vacate and reenter the same judgment, it has the authority to change it. Clearly, that was not the intent of the Congress in enacting Rule 60(b)(6). And clearly, the fact that that rule was adopted at the same session of the Congress as the amendments to Rule 77(d) and the promulgation of F.R.A.P. 4(a) is dispositive of Respondents' argument.

II.

The Court of Appeals Manifestly Exceeded its Constitutional and Statutory Authority in a Diversity Case by Creating and Applying a New Presumtion that Shifted the Burden of "Disproving" an Insurable Loss to the Insurer in Disregard of Applicable State Law.

Petitioner does not herein propose to restate or reargue all of its reasons for granting certiorari advanced in its original petition. However, it is significant that Respondents on page 19 of their Brief assert that the Court of Appeals did not shift the burden of proof to Petitioner and then concede on page 20 that:

> "The burden of proving legitimacy under these undisputed factual circumstances shifts to Petitioner."

It is clear that there was a shifting of the burden of proof on the issue of insurable loss that was achieved by the Court of Appeals in its opinion. It is equally clear that there is no Florida law justifying such a shifting of the burden of proof. The only authority ever cited for such a proposition involved a contest between a member of a board of directors and a shareholder to whom the defendant owed a fiduciary duty. That was the articulated basis for the presumption. Thus, the effect of the holding of the Court of Appeals and the arguments urged by Respondents is to render the fidelity insurer of closely-held interlocking corporations to be a fiduciary in relation to its insureds. There is no law, Florida, federal, or otherwise, that supports such a principle. It is totally foreign to all established principles of insurance law. Nor is it applicable only to the "unique" set of circumstances in this case.

Neither Petitioner nor Respondent quarrels with the holding in the first Court of Appeals opinion that the creditors of the insured are not covered by the fidelity bond under established principles of Florida law. But that principle has been effectively repudiated by the adoption of a presumption that shifts the burden to the insurer to "disprove" that an insured loss has been suffered. Not only is the far-reaching import of this decision suggestive of review by this Court because of

its application to other fields of insurance law, but also because the Court of Appeals exceeded its Constitutional and statutory authority in declaring new substantive principles of state law totally foreign to that state's jurisprudence. When faced with a question that has yet to be resolved by the state court, a federal court's obligation is to resolve it in a manner consistent with accepted state policy. Such federal tribunal is not free to totally disregard existing state law and promulgate new principles that shift to the opposite party the burden of "disproving" that such law would be accepted if argued in that state. The Federal Court of Appeals has no statutory or constitutional authority to materially alter the substantive law of the State of Florida. Yet that is the effect of the Court's decision. And that is the power argued as a justification for this opinion. This excess of power and its drastic consequences are the principal reasons why Petitioner has urged that certiorari be granted and the merits reviewed.

CONCLUSION

For the foregoing and all other reasons asserted in its original petition for certiorari, Petitioner prays that this Court grant petition for certiorari and upon full hearing, hereof, reverse the opinion and judgment of the Court of Appeals for the Fifth Circuit.

Respectfully submitted,
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that three true and correct copies of the foregoing were mailed by United States mail, postage prepaid, addressed to the following individual at the following address:

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